

Achieving Strong, Sustained and Shared Growth in Africa in the Post-crisis Global Economy¹

**Prepared for the 2010 KOAFEC Ministerial Conference
(Seoul, September 14-17, 2010)**

By:

The AfDB, the Committee of Ten, United Nations Economic Commission for Africa (UNECA), and the African Union Commission, in collaboration with the Korea Institute for International Economic Policy (KIEP).

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¹ An earlier version of the paper was presented at the 2010 KOAFEC Ministerial Conference under the title 'Africa's Voice on Development: Proposals for G20 Summit in Seoul'.

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Summary²

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² This summary is based on the full version of the paper. An earlier version of the paper was presented at the 2010 KOAFEC Ministerial Conference in Seoul under the title 'Africa's Voice on Development: Proposals for G20 Summit in Seoul'.

³ The National Treasury of South Africa and the Central Bank of Kenya provided very useful materials, which are in a separate Annex.

Achieving Strong, Sustained and Shared Growth in Africa in the Post-crisis Global Economy

The aftermath of the global financial and economic crisis, which Africa weathered on balance well, presents a unique opportunity to rethink continent's economic strategies for the decade ahead.⁴ Given the continent's vast economic potential, the poverty reduction agenda 'beyond MDG' should focus on building a prosperous Africa. The way Africa can achieve prosperity is through economic growth, which is strong, sustained and shared.

The African Development Bank, the UNECA and the AUC undertook a joint study in collaboration with the Korea Institute for International Economic Policy, which highlights key challenges ahead of the continent to reach strong, sustained and shared growth. The study provides evidence on the impact of the crisis and longer term trends, examples of good international practices in selected areas, policy recommendations, and suggested actions for the way forward. It aims to contribute to promoting Africa's voice on development globally and especially in the debates at the G20.

I. Africa in the aftermath of the global financial crisis

Africa's immense economic potential has been reconfirmed by the pre-crisis growth and a fast and strong rebound from the crisis. At an average of 5.6 percent a year, Africa was one of the fastest growing developing regions during 2001-08. The growth was spread across countries, with about 40 percent of them growing at or above 5 percent, with many sectors contributing (resources, finance, retail, agriculture, transportation and telecommunications).⁵ The continent has also shown unexpected resilience during the global financial and economic crisis and is now staging a robust comeback (Figure 1). Africa is projected to be the second fastest growing region in 2011, after Asia.⁶ This strong rebound has brought a renewed recognition of the continent's substantial economic potential.

With Africa rebounding, **how should the continent exit from the crisis measures?** Effective counter-cyclical response has helped some African countries weather the crisis. Short-term stabilization policies need to be phased out not to jeopardize debt sustainability and undermine investor confidence, while strategic capital investments to

⁴ The real GDP grew on average by only 2.5 percent, but the performance varied from 6.8 percent decline (Seychelles) to 9.9 percent growth (Ethiopia). The impact on SSA was severe, as growth collapsed from an average of 6.1 percent during 2001-08 to 1.6 percent in 2009. Since the crisis was an external shock, the countries that were more open to trade and grew faster before the crisis experienced larger growth falls in 2009. Correspondingly, they are expected to recover the fastest, alongside the global revival.

⁵ McKinsey&Co. (2010), 'Lions on the Move: The progress and potential of African economies', which discusses these developments, underscores that Africa's growth has been creating business opportunities in at least four groups of industries: consumer-facing industries, agriculture, resources, and infrastructure.

⁶ African Development Bank and OECD (2010), 'African Economic Outlook 2010', AfDB: Tunis and OECD: Paris.

raise productivity need to be made. Given the fragile global recovery, where feasible, African governments may want to keep a looser stance also in 2011 to prevent stop-go patterns and ensure continued rebound of their economies. When exiting the interventionist policies, fiscal consolidation should in most cases precede monetary tightening, even if it may be technically and politically more complex. In some countries, social outlays and public expenditures on infrastructure need to stay protected, and even scaled up to support social stability and post-crisis growth.

Strong, sustained and shared growth is a key priority for macroeconomic policy ahead,⁷ given that stabilization was mostly maintained throughout the crisis. Africa's high growth during 2001-08 was a positive turnaround, but it was not sufficient to narrow the income gap with more advanced economies. At the same time, about 40 percent of Africa's low-income countries (LICs) had inflation below 5 percent even though empirical evidence shows that such rates are usually not appropriate targets for LICs and may even hamper growth. To put Africa on a path of strong, sustained and shared growth, macroeconomic policy for the next decade needs to move from overemphasizing macroeconomic stability and to focus on growth. For example, countries that now have inflation above 10 percent and low growth (e.g., Nigeria) could stimulate growth while lowering inflation only to high single digits, as Nigeria intends to do. Countries that are expected to grow below their trend growth in 2010-11 with inflation in single digits (e.g., Kenya) could stimulate aggregate demand without fueling inflation (Figure 2).

With the policy objectives shifting to growth, **how can macroeconomic frameworks become more flexible but maintain credibility?** During the crisis, countries with more flexible macroeconomic frameworks fared better. To achieve greater flexibility of macroeconomic frameworks, pro-cyclical fiscal policies could be replaced by rule-based and counter-cyclical frameworks that leave room for discretion in case of unexpected shocks. African countries could aim for balanced budgets (after grants) over the cycle, with annual budgets anchored in medium-term expenditure frameworks. On the monetary side, where conditions allow, flexible inflation targeting (IT) regimes, now in place in South Africa and Ghana, could be considered by other emerging and frontier markets.

Unlocking entrepreneurship across regions and sectors, with well-designed and supportive policy and actions, would make growth not only strong but also shared and sustainable. Africa will achieve such growth if it is underpinned by a vibrant private sector and **productive entrepreneurship**. While the formal private sector remains limited, in some countries it has been thriving (e.g., Mauritius, South Africa). Dynamic private sectors have appeared in other countries, including the flower business in Uganda, leather processing in Ethiopia, and even the film industry 'Nollywood' in Nigeria. Industrial policy can play an important role in nurturing the entrepreneurial spirit across the continent, **not by picking winners**, but by removing obstacles to entrepreneurship in high-potential sectors and industries.

⁷ For growth to be sustainable, it needs to encompass social and environmental aspects.

Increasing resilience through mobilizing domestic resources would also make Africa's growth more sustainable and help prepare the continent for the next crisis. Most countries in Africa, especially in sub-Saharan Africa, face large resource gaps due to low domestic savings and high investment needs. These gaps can be reduced by raising domestic tax revenues – by deepening the tax base, strengthening tax administration and formalizing the informal sector. Private savings can be raised by banking sector reforms and through innovative ways such as leveraging the local wealth or securitizing future resource inflows (remittances, oil revenues). As many countries still rely on official aid to supplement their resources, donors need to disburse it in adequate amounts and in timely manner. Support through ODA needs to be guided by national expenditure priorities and balance the competing needs of the social sectors and longer term economic development. It also needs to be designed so as to crowd in private sector investment.

Building social safety nets would help ensure that growth is shared with the most vulnerable. The recent global financial and economic crisis has again underscored the importance of creating mechanisms in Africa to protect the most vulnerable segments of population against unexpected external shocks. As the global financial crisis has turned into a job crisis, African countries realized that they should be paying more attention to public works programs, such as labor-intensive infrastructure investment. Moreover, short-term social safety nets should be supplemented by well-targeted longer term protection programs to ensure shared growth in the medium term.

II. The decade ahead: overcoming obstacles, seizing opportunities

Obstacles to access to credit need to be eased, especially those pertaining to trade finance, SMEs and smallholder farmers. For export-dependent countries with limited access to trade finance, development of multilateral trade finance programs and national guarantee programs would facilitate the flow of trade at all times and hence regional integration. There are number of ways in which some of the underlying constraints of rural credit can be addressed by modern technology. For example, transaction costs can be reduced with mobile banking (e.g., Kenya) and information asymmetries reduced with biometric technology (as it is being investigated in Malawi). Remittances can be leveraged for SME lending through, for example, securitization of these flows (through 'diaspora bonds').

To make the most out of globalization, attracting stable private capital flows is a priority in the light of the large development needs, especially when climate change implications are considered. At the same time, volatility of these flows will need to be managed. Where inflows are particularly large and do not reflect economic fundamentals, targeted controls at short term inflows could be considered on a temporary basis. **African countries need an increased access to world markets to expand their exports.** They should continue to demand relaxation of rules of origin requirements, lowering non-tariff barriers, and efficient delivery of aid for trade. They need to reiterate calls for a balanced and early conclusion of the Doha Development Round. Developed countries should discourage protectionist practices in trade and finance, which would lead to low levels of trade volume and capital flows, and to put an end to agricultural subsidies.

Attracting development-friendly FDI would help boost growth,⁸ provided that host countries create a competitive environment so that foreign investors can enhance productivity of existing domestic activities and generate positive spillovers. Open trade and investment regimes contribute to the creation of such environment. Given the linkages between trade and investment, measures to encourage regional integration and trade could bring in additional ‘market-seeking’ FDI. Moreover, some minimal threshold of development is needed for the host countries to benefit from FDI. Raising human capital, technological capacity and developing infrastructure are thus crucial to attract ‘development-friendly’ FDI and generate positive spillovers for domestic economies.

Regional integration can be a source of resilience during crises and of sustainable growth. Integration would help African countries diversify their economies and build up protection against external shocks, while increasing efficiency due to the economies of scale. At the same time, efforts to promote regional integration need to be well-designed and coordinated. The numerous and overlapping regional trade agreements carry substantial inefficiencies and need to be streamlined. To address the costs of regional integration, strategies include a transparent, equitable, and rule-based system for sharing gains and resolving disputes. Moreover, regional agreements need to be incorporated in national strategies and policies, with involvement of the civil society in their formulation and implementation. Finally, regional strategies have to focus on developing areas of industrial complementarity to raise countries’ capacity to trade.

A stronger human capital base is needed to transform African countries into knowledge-based societies. In today’s knowledge-based world, no country can thrive in the global or regional economy without a capacity to generate, transmit, and utilize new knowledge. There is substantial mismatch between the demands of modern economies and skills possessed by the recent university graduates in most African countries. While unemployment among the educated is high, shortages of skills, especially in ICT, high-level technical skills and foreign languages persist. To address them, a comprehensive overhaul of Africa’s higher education systems is needed. In parallel, new sources of financing for higher education need to be identified, including from the private sector. Different forms of state support should also be explored, including credit-guarantees, loan subsidies, and grants. Africa should also revamp immigration policies to ease mobility of skilled workers to help address skill shortages.

Reducing the substantial productivity gap will also require much stronger human capital base. Low-productivity agriculture still accounts for most employment in many African LICs, with the surplus labor typically working in the informal urban sector. However, in some frontier markets (e.g., Uganda, Mozambique), labor productivity accelerated in recent years and grew about as rapidly as in India. The large productivity gaps with advanced economies also imply that through the catch up process, African countries could grow at rates approaching 10 percent annually. With such rates they even could, on average, converge to the per capita income levels of the new EU members around the year 2050. For this to happen, structural transformation to high value-added

⁸ ‘Development-friendly FDI stimulates jobs creation, is a channel for transfers technology and managerial know-how, does not disrupt local communities and helps countries embark on green growth path.

activities would need to markedly accelerate, while an enabling external environment and improved educational systems would also need to be in place. Moreover, the importance of strengthening institutions and improving governance in Africa cannot be overstated.

Closing Africa's infrastructure deficit is a key priority in this regard, as the low levels of public goods and productivity-enhancing investments have been particularly damaging the continent's growth and development. For example, World Bank estimates suggest that if the entire SSA had Mauritius' infrastructure, its growth of real GDP per capita would increase by 2.3 percentage points a year. Similarly, North Africa's growth would rise by 1.1 percentage point a year. Moreover, infrastructure services on average are costly relative to other developing regions and to the purchasing power of consumers. Still, vast differences exist across countries and sectors. Oil exporters have a greater deficit than oil importers, in part because most of them spent the windfall revenues of 2000s mainly on consumption rather than investment. Among sectors, the deficit is most pronounced in the power sector, while the ICT gap is much smaller. In fact, several African frontier markets are ahead of India in the usage of mobile phones, demonstrating Africa's capacity to rapidly adopt modern technology.

Innovative forms of financing for infrastructure will need to be found while traditional mechanisms strengthened, given the large financing needs – currently about \$93 billion a year total and still \$76 billion a year if all the efficiencies were addressed. Given the central role of public funds in financing infrastructure investments, increased efficiency in their allocation and disbursement must be a priority. Among emerging donors, China's infrastructure financing in Africa has increased rapidly, often backed by future export revenues (oil, cocoa, iron). Innovative ways to mobilize private funds include Kenya's domestic issuance of infrastructure bonds, Ghana's 2007 Eurobond issuance, and the current plans of Nigeria to establish oil-financed infrastructure fund (sovereign wealth fund).

Africa is well positioned to embark on a low carbon growth and development path, given its abundant natural and biological resources. Investment opportunities in Africa's renewable energy sources, such as solar, hydro, wind, thermal and biomass could draw international financing. They would not only help address global climate change and local energy shortage problems, but also create a new global market.⁹ Yet public resources alone cannot fully cover the costs of climate change and set clean development schemes customized for each African country; private financing will need to be mobilized as well. Moreover, African countries should actively utilize projects boosting green industries, such as clean energy or green agriculture, initiated by multilateral or regional institutions. The African Development Bank's issuances of clean energy bonds in 2010 are clearly steps in the right direction.

Africa needs to advance its voice in the global economic arena to mobilize attention on long-standing obstacles to its development and seize opportunities. Even though many African countries depend on access to concessional funds from the IFIs, they have only

⁹ A relevant example to the African context is South Africa's Green Economy Summit (May 2010), which called for development of green growth policies and regulations to support the clean technologies.

marginal voice in the governance of these institutions. The current international financial and economic architecture remains dominated by the major economies. Yet a cardinal lesson from successful development elsewhere, in particular Asia, is the importance of country ownership and commitment, of policy and strategies being determined by country circumstances, the country's own priorities. This lesson has to be reflected in the key policy and standard-setting organizations, and when decisions are made on the allocation and use of resources for Africa. Hence there is a need for continental and regional representation in the key policy and decision making international structures. Greater scope is also needed for African-led institutions to engage on equal terms in global discussions, to put forward African perspectives, and to draw attention to the implications of decisions by global bodies for Africa. In this regard, Africa's institutionalized representation in the G20 is a priority.

III. Africa as a new global growth pole

The pre-crisis growth and the rebound have clearly demonstrated Africa's capacity to become a new global growth pole. Africa has changed -- from historically a slow growth region to one of the fastest growing regions in the world. Fundamental changes took place on the continent showing an improving economic and socio-political environment. African economies are now expected to become a new source of global economic growth. The sources of this growth stem from improved capacity to design and implement efficient policies, abundant natural resources, a growing labor force, and rapid urbanization.

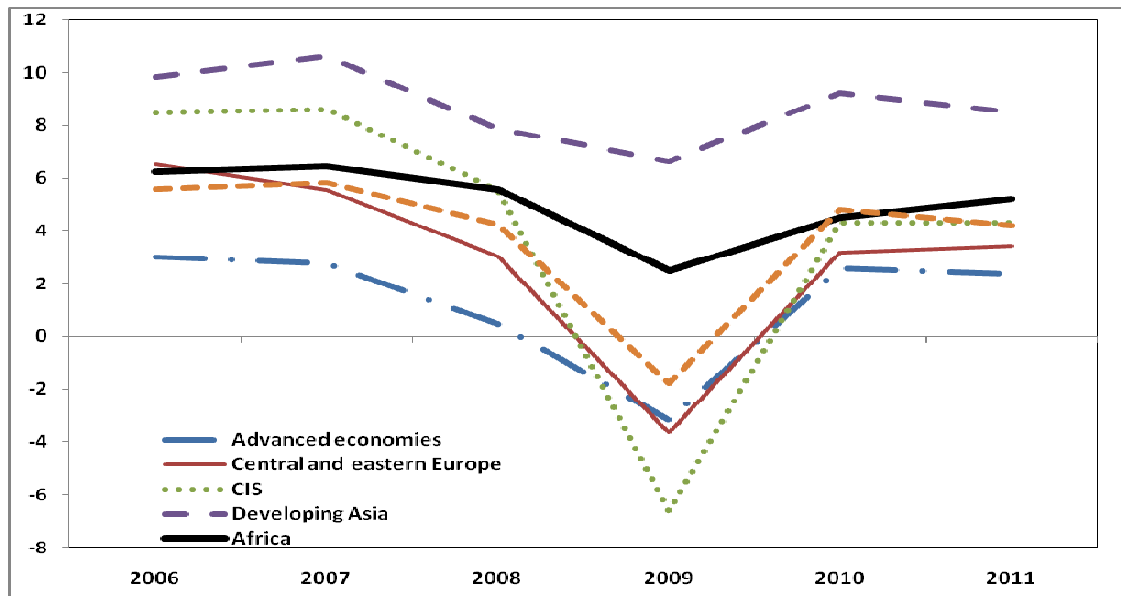
Emerging positive perceptions would materialize into even more private investment, increased trade, and accelerated growth in Africa. If all African countries would catch up with the 7 percent growth rate of fast-growing economies on the continent and continue to grow at that rate, the GDP per capita would double in 10 years and quadruple in 20. Africa's collective GDP is estimated to reach \$2.6 trillion in 2020, and consumer spending is set to stand at \$1.4 trillion.¹⁰ In that case, Africa would play a significant role in rebalancing of the global economy, not only through exports, but also as a major consumer market with its large population. Supporting Africa's current efforts to realize its immense economic potential could thus soon be beneficial to the entire world.

In Africa an alternative can be found to what is now called the new normalcy in the global economy of low growth, high unemployment and instability on the one hand, high levels of absolute poverty, and unexplored human potential. Economic history reveals that large part of poverty reduction can be achieved by growth – but it has to be strong, shared and sustained. If Africa can achieve at least two decades of such growth it could become a new source of dynamism in the global economy. Further, although Asian markets continue their breathtaking expansions, China and India would have to increase their consumer spending markedly if it is to replace the growth lost by advanced countries since the onset of the crisis. The world needs **a new driver of consumer**

¹⁰ McKinsey Global Institute (2010), *Lions on the Move: The Progress and Potential of African Economies*, McKinsey Global Institute: Washington DC.

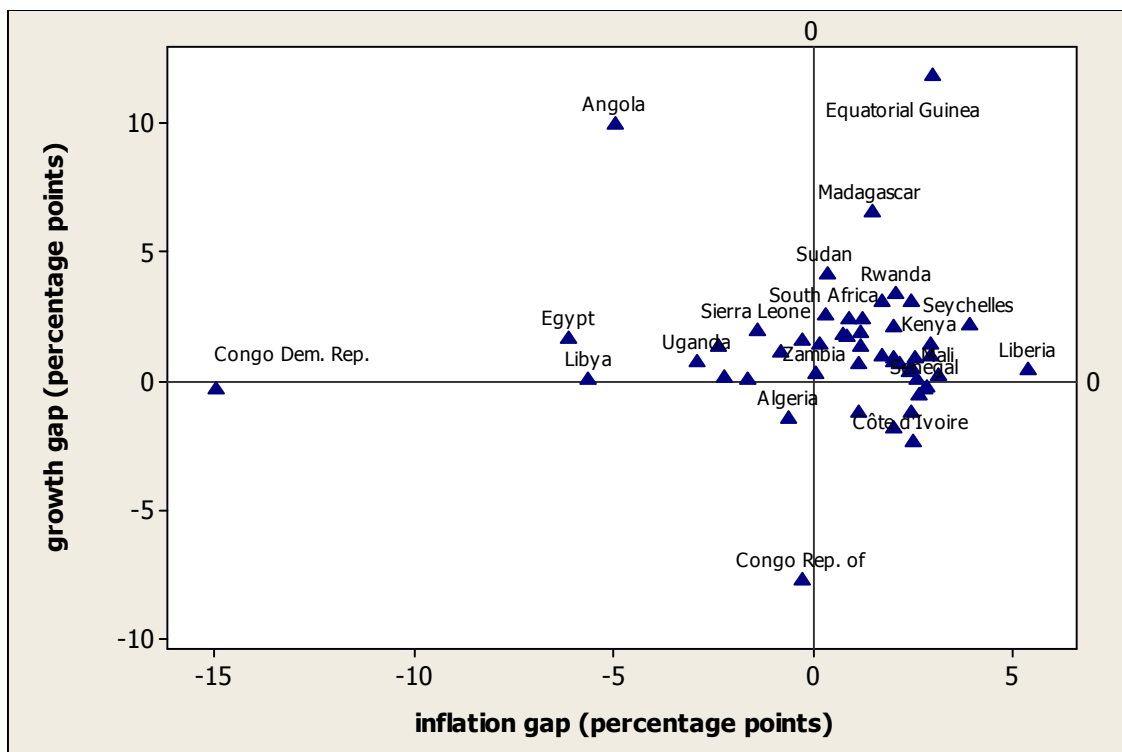
demand, a new market, and a new dynamo, which is Africa. Future growth in the world economy and future jobs in the developing world will depend on harnessing both the productive potential and the untapped consumer demand of the continent. Therefore, every job not created, every business lost and every entrepreneurial idea not realized in Africa are drivers lost to global growth.

Figure 1. Africa and other regions, real GDP growth (2006 – 2011), percent



Sources: African Development Bank database and IMF WEO database.

Figure 2. Africa: room to grow and room to inflate 1/



Source: Authors' calculations based on the African Development Bank database. 1/ Growth gap is calculated as the difference between the potential growth (average of 2006 – 2008) and the actual growth in 2010. Inflation gap is calculated as the difference between the targeted/trend inflation (average of 2001-2008) and the actual inflation in 2010. In cases where inflation trend was below 5 percent, target was set as 5. Similarly, where inflation trend was above 10 percent, target was set at 10. Positive growth gaps mean that countries should aim at higher growth; positive inflation gap means that there may be some room to inflate, especially for low income countries with inflation below 5 percent.

**Atteindre une croissance africaine forte, soutenue et partagée
dans une économie mondiale d'après crise**

Version Condensée¹¹

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Par:

La Banque Africaine de Développement (BAD), la Commission Economique des Nations Unies pour l'Afrique (CEA), et la Commission de l'Union Africaine (CUA), en collaboration avec l'Institut Coréen de Politique Economique Internationale (KIEP).¹²

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¹¹ Cette version est basée sur la version complète du papier. Une version antérieure du document a été présenté à l'édition de la conférence ministérielle de la KOAFEC à Seoul sous le titre « La voix de l'Afrique sur le développement : proposition le Sommet de G20 à Séoul »

¹² La Banque Centrale du Kenya et le Ministère des Finances de l'Afrique du Sud ont procuré au Groupe de l'information statistique et analytique très utile qui est reproduite dans des annexes séparées.

Atteindre une croissance africaine forte, soutenue et partagée dans une économie mondiale d'après crise

La crise financière et économique mondiale, que l'Afrique a surmontée, offre au continent une occasion unique pour revoir ses stratégies économiques pour la décennie à venir¹³. Compte tenu du vaste potentiel économique du continent, le plan de la réduction de la pauvreté au-delà des OMD devrait se concentrer sur la construction d'une Afrique prospère. L'Afrique ne peut atteindre la prospérité que par une croissance économique forte, soutenue et partagée.

La Banque africaine de développement, la CEA et la CUA ont entrepris une étude conjointe en collaboration avec l'Institut coréen de politique économique internationale qui met l'accent sur les principaux défis que le continent doit relever pour atteindre une croissance forte, soutenue et partagée. Cette étude revient également sur l'impact de la crise et les tendances à long terme, cite des exemples de bonnes pratiques internationales dans certains domaines, et suggère des recommandations de politique et des actions pour l'avenir. Elle vise à contribuer à la promotion de la voix africaine sur le développement globalement et plus spécialement dans les délibérations du G20.

IV. L'Afrique à la suite de la crise financière mondiale

L'énorme potentiel économique de l'Afrique a été reconfirmé par la croissance d'avant la crise et une reprise rapide et forte à la suite de cette crise. Avec un taux de croissance moyen de 5,6% par an, l'Afrique comptait parmi les régions en développement ayant connu une croissance très rapide au cours de la période 2001-2008. La croissance était répartie entre les pays, avec près de 40 pourcent d'entre eux

¹³ Le PIB réel a augmenté en moyenne de seulement 2,5 pour cent, mais la performance a varié de 6,8 pourcent (Seychelles) à 9,9 pourcent de croissance (Ethiopie). L'impact sur l'Afrique subsaharienne a été sévère, la croissance s'est effondrée passant d'une moyenne de 6,1 pourcent pendant la période 2001-08 à 1,6 pourcent en 2009. Comme la crise a été un choc externe, les pays qui ont été plus ouverts au commerce et qui ont révélé une croissance rapide avant la crise ont connu les baisses de croissances les plus importantes en 2009. En conséquence, on s'attend à ce qu'ils se relèvent plus rapidement, au cours de la reprise mondiale.

affichant un taux de croissance supérieur ou égal à 5%, avec la contribution de plusieurs secteurs (Ressources humaines, finances, commerce de détail, agriculture, transports et télécommunications)¹⁴. Le continent a également fait preuve d'une capacité de résistance au choc pendant la crise financière et économique mondiale et connaît actuellement une reprise en force. (Graphique 1). L'Afrique prévoit d'être la seconde région en termes de croissance en 2011, derrière l'Asie¹⁵. Cette forte croissance a donné lieu à une reconnaissance renouvelée de l'important potentiel économique du continent.

Maintenant que l'Afrique est en pleine reprise, **comment doit-elle retirer les mesures mises en place pendant la crise?** Les politiques anticycliques ont permis à certains pays africains de surmonter la crise. Ces politiques de stabilisation à court terme doivent être relaxées petit à petit pour ne pas compromettre la soutenabilité de la dette et trahir la confiance des investisseurs, de même que des stratégies d'investissements de capital pour élever la productivité doivent être prises. Cependant, vue la fragilité de la reprise mondiale, dans la mesure du possible, les pays africains devraient continuer avec des politiques non-restrictives même en 2011 pour garantir une reprise soutenue de leurs économies. Pour sortir des politiques interventionnistes, bien qu'il puisse être techniquement et politiquement plus complexe, l'assainissement des finances publiques doit dans la plupart des cas précéder le resserrement monétaire. Dans certains pays, les dépenses sociales et d'infrastructure doivent être protégées et même augmentées pour soutenir la stabilité sociale et la croissance de la période après crise.

Une croissance forte, soutenue et partagée est une priorité dans la mise en œuvre de la politique macroéconomique,¹⁶ étant donné que la stabilisation était en grande partie maintenue pendant la crise. Bien que la forte croissance de l'Afrique au cours de la période 2001 – 2008 fut assez forte, cela n'a pas suffi à réduire l'écart de revenu avec les pays les plus avancés. Parallèlement, le taux d'inflation qu'affichaient près de 40% de pays africains à faible revenu était de moins de 5%, bien que l'expérience

¹⁴ McKinsey&Co. (2010), 'Lions on the Move: The progress and potential of African economies', qui traite de ces développements, souligne que la croissance en Afrique a créé des opportunités d'affaires dans au moins quatre groupes d'industries: les industries de biens de consommation, de l'agriculture, des ressources naturelles, et des infrastructures

¹⁵ Banque africaine de développement et OCDE (2010) *Perspectives Economiques en Afrique*, BAD: Tunis et OCDE: Paris.

¹⁶ Une croissance soutenable requière des aspects sociaux et environnementaux.

montre que de tels taux d'inflation ne sont généralement pas indiqués pour les pays à faible revenu et pourraient même compromettre la croissance. Pour mettre l'Afrique sur la voie d'une croissance forte, soutenue et partagée, la politique macroéconomique au cours de la prochaine décennie doit cesser d'accorder trop d'importance à la stabilité macroéconomique et mettre l'accent sur la croissance. Par exemple, les pays affichant actuellement un taux d'inflation supérieur à 10% et un faible taux de croissance (ex. Nigeria) pourraient procéder à la stimulation de la croissance tout en réduisant le taux d'inflation jusqu' autour de 9% comme ce que le Nigeria a l'intention de faire. Les pays qui escomptent un taux de croissance inférieur à la tendance en 2010-2011 avec un taux d'inflation autour de 9% (ex. Kenya) devraient stimuler la demande sans provoquer l'augmentation du taux d'inflation (Graphique 2).

Comment les cadres macroéconomiques peuvent-ils devenir plus souples tout en restant crédibles pendant que les objectifs de politiques s'orientent vers la croissance ? Pendant la crise, les pays aux cadres macroéconomiques plus souples se sont mieux tirés d'affaire. Pour plus de souplesse des cadres macroéconomiques, les politiques budgétaires pro-cycliques pourraient être remplacées par des cadres anticycliques fondés sur des règles permettant la discrétion en cas de chocs. Les pays africains pourraient avoir pour objectif les équilibres budgétaires (après les subventions) au cours du cycle, avec des budgets annuels ancrés dans les cadres de dépense à moyen terme. Sur le plan monétaire, tant que les conditions le permettent, les régimes souples de ciblage de l'inflation, actuellement en place en République Sud-africaine et au Ghana, pourraient être envisagés par d'autres marchés émergents ainsi que d'autres marchés dynamiques.

La promotion de l'esprit d'entrepreneuriat appuyée par une politique industrielle bien élaborée, contribuera à rendre la croissance non seulement forte, mais également partagée et soutenue. L'Afrique ne réalisera cette croissance que si elle dispose d'un secteur privé dynamique et d'un **esprit d'entrepreneuriat**. Bien que le secteur privé formel reste sous-développé, il enregistre de bonnes performances dans certains pays (ex. Maurice, République Sud-africaine). Des secteurs privés dynamiques continuent à émerger dans d'autres pays, notamment l'horticulture en Ouganda, le traitement du cuir en Ethiopie et même l'industrie cinématographique 'Nollywood' au Nigeria. La politique industrielle peut jouer un rôle important dans le développement de l'esprit d'entrepreneuriat à travers le continent, **non pas en choisissant « les gagnants »**, mais

en réduisant les barrières à l'entrepreneuriat dans les secteurs et industries à forte potentialité.

Le renforcement de la capacité de résistance au choc à travers la mobilisation des ressources nationales contribuera également à rendre la croissance africaine plus soutenue et permettra à ce continent de se préparer à faire face aux prochaines crises. La plupart des pays africains, en particulier ceux de l'Afrique sub-saharienne, sont confrontés à des déficits énormes en matière de ressources, en raison du faible taux d'épargne nationale et des besoins énormes en matière d'investissement. Ces déficits peuvent être comblés par l'augmentation des revenus générés par la taxe intérieure – en renforçant l'administration fiscale et en formalisant le secteur informel. L'épargne privée peut être stimulée par le biais des réformes du secteur bancaire et à travers les voies novatrices comme la mise en valeur des fortunes locales ou la titrisation des flux de capitaux (e.x., transferts des migrants, recettes pétrolières). Etant donné que de nombreux pays continuent à compter sur l'aide publique pour combler leurs déficits, les bailleurs de fonds doivent non seulement augmenter l'aide mais aussi assurer un déboursement prévisible. Le support par l'APD doit être guidé par les priorités des dépenses nationales et par un équilibre entre les besoins concurrents des secteurs sociaux et le développement économique de long terme.

La mise sur pied des filets de sécurité sociale permettra de s'assurer que la croissance est partagée avec les plus vulnérables. La récente crise financière mondiale a une fois de plus souligné la nécessité de mettre en place en Afrique, des mécanismes de protection des couches les plus vulnérables de la population contre les chocs extérieurs inattendus. La crise s'étant transformée en crise de l'emploi, les pays africains ont apprécié l'importance des programmes de création d'emploi comme les travaux publics, les investissements dans les infrastructures à forte intensité de main-d'œuvre. Par ailleurs, des filets de sécurité sociale doivent être mis en œuvre à travers des programmes de protection à plus long terme bien ciblés, en vue de garantir la croissance partagée à moyen terme.

V. La décennie à venir: surmonter les obstacles, saisir les opportunités

Les obstacles à l'accès au crédit doivent être levés, en particulier ceux ayant trait au financement du commerce ainsi que le crédit aux PME et aux petits exploitants

agricoles. En ce qui concerne les pays dépendant des exportations et ayant un accès limité au financement du commerce, l'élaboration des programmes multilatéraux de financement du commerce ainsi que les programmes nationaux de garantie, contribueront à faciliter les flux commerciaux, et en conséquence, l'intégration régionale. Il existe de nombreuses façons parmi lesquelles certains obstacles sous-jacents au crédit rural peuvent être levés à travers la technologie moderne. A titre d'exemple, les coûts des transactions peuvent être réduits à travers les transactions bancaires mobiles (ex. du Kenya) et les asymétries de l'information diminuées à travers la technologie biométrique (méthode qui fait l'objet d'investigation au Malawi). Les transferts de fonds de migrants peuvent servir d'effet de levier en faveur des crédits aux PME, par exemple à travers la titrisation de ces flux (à travers 'les bons de la diaspora').

Afin de tirer le meilleur parti de la mondialisation, l'attraction de flux de capitaux privés stables est une priorité pour le développement. Par ailleurs, la volatilité de ces flux de capitaux doit être gérée. Lorsque les flux entrants sont particulièrement importants et ne reflètent pas les fondamentaux économiques, des contrôles sélectifs de ces flux pourraient être envisagés sur une base temporaire. **Les pays africains ont besoin d'un accès accru aux marchés mondiaux pour accroître leurs exportations.** Ils doivent continuer à exiger l'assouplissement des règles d'origine, la réduction des barrières non tarifaires, et une prestation efficace de l'aide pour le commerce. Ils ont besoin de réitérer les appels à une conclusion équitable et rapide du Cycle de Doha pour le développement. Les pays développés devraient décourager les pratiques protectionnistes dans le commerce et les finances qui réduisent le volume des échanges commerciaux et des flux de capitaux ; ils devraient notamment mettre fin aux subventions agricoles.

Attirer des IDE productifs pourrait permettre de stimuler la croissance¹⁷, à condition que les pays hôtes créent un environnement compétitif afin de permettre aux investisseurs étrangers de renforcer la productivité des activités nationales existantes, en vue de générer des retombées positives. Des régimes libres de commerce et

¹⁷ Le développement des IDE engendrant la création d'emplois, est un canal pour les transferts de technologie et de savoir-faire managérial, il ne perturbe pas les communautés locales et aide les pays à s'engager sur le chemin de la croissance verte.

d'investissement favorisent la création d'un tel environnement. Etant donnés les liens étroits entre le commerce et les investissements, des mesures de promotion de l'intégration et du commerce régional peuvent attirer des IDE 'à la recherche des marchés'. Par ailleurs, un seuil minimum de développement est nécessaire pour permettre au pays hôte de bénéficier des IDE. Le développement du capital humain et technologique est en conséquence d'une importance capitale pour attirer des IDE productifs et la génération des retombées positives pour les économies nationales.

L'intégration régionale peut constituer une importante source de résistance au choc pendant les crises et de croissance durable.. L'intégration permettra aux pays africains de diversifier leurs économies et de se prémunir contre les chocs extérieurs, tout en renforçant l'efficacité résultant des économies d'échelle. Parallèlement, les efforts de promotion de l'intégration régionale doivent être bien coordonnés. Les nombreux accords commerciaux régionaux qui se chevauchent, présentent des lacunes de taille et doivent être rationalisés. Pour réduire les coûts de l'intégration régionale, il faudra notamment mettre sur pied un système transparent, équitable et fondé sur les règles claires de partage des gains d'échange et de règlement des différends. Par ailleurs, les accords régionaux doivent être intégrés dans les stratégies et politiques nationales dont la formulation et la mise en œuvre doivent bénéficier de la participation de la société civile. Enfin, les stratégies régionales doivent se focaliser sur le développement des zones de complémentarité industrielle afin d'augmenter la capacité commerciales des pays.

Une base de capital humain plus solide est nécessaire pour la transformation des pays africains en sociétés où le savoir occupe une place centrale. Dans le monde actuel fondé sur le savoir, tout pays est contraint de disposer de capacité adéquate de générer, de transmettre et d'utiliser de nouvelles connaissances. Il existe une disparité de taille entre les exigences et attentes des économies modernes et la compétence des récents diplômés des universités dans la plupart des pays africains. En plus du taux de chômage élevé des personnes éduquées, il se pose encore le problème de manque de compétences, particulièrement dans le domaine des TIC, des connaissances techniques de haut niveau et des langues étrangères. Pour résoudre ces problèmes, il est nécessaire de procéder à une restructuration totale du système d'enseignement supérieur en Afrique. Par ailleurs, il est nécessaire d'identifier de nouvelles sources de financement de l'enseignement supérieur, notamment par le secteur privé. Il est également nécessaire d'explorer de différentes formes d'appui du gouvernement, notamment, les garanties de

crédit, les subventions et les crédits. L'Afrique devrait également revoir les politiques d'immigration pour faciliter la mobilité des travailleurs qualifiés pour aider à faire face au déficit de compétence.

La réduction de l'important déficit en matière de productivité nécessitera également une base de capital humain solide. La majeure proportion de chômage dans de nombreux pays africains à faible revenu s'explique encore par une agriculture à faible rendement, ainsi que le surplus de la main-d'œuvre exerçant en général dans le secteur urbain informel. Cependant, dans certains marchés dynamiques (Ouganda et Mozambique, à titre d'exemple), la productivité du travail a connu une accélération au cours des récentes années et a enregistré une croissance presque aussi rapide qu'en Inde. Le grand déficit de productivité par rapport aux économies développées indique qu'à travers le processus de rattrapage, les pays africains pourraient afficher un taux de croissance annuel avoisinant 10%. Avec de tels taux, les pays africains pourraient même, en moyenne, se rapprocher des niveaux de revenu par habitant des nouveaux pays membres de l'UE autour de l'année 2050. Pour la réalisation d'une aussi rapide croissance, la transformation structurelle en activités à haute valeur-ajoutée doit connaître une accélération sensible, alors qu'un environnement extérieur favorable et des systèmes éducatifs améliorés. En outre, l'importance du renforcement des institutions et l'amélioration de la gouvernance en Afrique ne peut pas être surestimée.

La résorption du déficit de l'Afrique en matière d'infrastructures constitue une priorité de taille, étant donné que les niveaux faibles des biens publics et l'amélioration médiocre de la productivité des investissements ont eu des effets néfastes sur le développement et la croissance du continent. Par exemple, les estimations de la Banque mondiale suggèrent que si l'ensemble des pays de l'Afrique sub-saharienne disposait des infrastructures de l'Ile Maurice, la croissance du PIB réel par habitant connaîtrait une augmentation annuelle de 2,3 points de pourcentage. De même, la croissance de l'Afrique du Nord enregistrerait une augmentation annuelle de 1,1 point de pourcentage. Par ailleurs, les services infrastructurels sont en moyenne plus chers en Afrique par rapport aux autres régions en développement et au pouvoir d'achat des consommateurs. Des disparités énormes sont observées à travers les pays et secteurs. Les pays exportateurs de pétrole affichent un déficit supérieur à celui des pays importateurs de l'or noir. Cette situation s'explique en partie par le fait que la plupart d'entre eux ont consacré la manne des années 2000 principalement à la consommation plutôt qu'aux investissements. Le secteur dans lequel le déficit se fait le plus sentir est celui de l'énergie, alors qu'il est de loin moins perceptible dans le secteur des TIC. En effet, de

nombreux marchés dynamiques africains se classent avant l'Inde en matière d'utilisation des téléphones portables ; ce qui illustre la capacité africaine à adopter rapidement la technologie moderne.

Il sera nécessaire de trouver **des formes novatrices de financement des infrastructures** parallèlement au renforcement des mécanismes traditionnels, vu l'énorme besoin financement actuellement environ 93 milliards de dollar EU par an en total et plus 76 milliards de dollar EU par an, si tout les gains d'efficacités sont atteints. Vu le rôle central des fonds publics dans le financement des investissements infrastructurels, le renforcement de l'efficacité dans leur allocation et leur décaissement est une priorité. En ce qui concerne les bailleurs de fonds émergents, le financement des infrastructures par la Chine en Afrique a connu une croissance rapide, souvent soutenue par les revenus d'exportation futurs (pétrole, cacao, fer). Parmi les moyens de mobilisation des fonds privés, on peut citer l'émission nationale des obligations infrastructurelles au Kenya, l'émission des Euro-obligations par le Ghana en 2007 ainsi que le plan de création d'un Fonds d'infrastructure financé par les revenus pétroliers au Nigeria (Fonds souverain de patrimoine).

L'Afrique est mieux placée pour se lancer sur une voie de croissance et développement à faible émission de carbone, vu ses abondantes ressources naturelles et biologiques. Les opportunités d'investissement dans les sources d'énergie renouvelable en Afrique à l'instar de l'énergie solaire, de l'hydroélectricité, de l'énergie éolienne et thermique ainsi que de la biomasse, pourraient attirer des financements internationaux. Non seulement ces opportunités d'investissement permettront de lutter contre les changements climatiques ainsi que les problèmes locaux relatifs aux pénuries énergétiques, elles constitueront également l'occasion de créer un nouveau marché mondial.¹⁸ Mais les ressources publiques toutes seules ne peuvent pas couvrir totalement les coûts du changement climatique et permettre de mettre sur pied des plans de développement adaptés à chaque pays africain; des financements privés doivent également être mobilisés. Par ailleurs, les pays africains doivent activement capitaliser sur les projets stimulant les industries vertes, à l'instar de l'agriculture basée sur l'énergie propre ou agriculture verte initiés par les institutions multilatérales et

¹⁸ L'exemple approprié au contexte africain est le Sommet sur l'économie verte organisé par la République Sud Africaine en mai 2010 qui a lancé un appel en faveur de l'élaboration des politiques et des réglementations de croissance verte en vue d'appuyer le recours aux technologies propres.

régionales. L'émission des bons d'énergie propre par la Banque africaine de développement en 2010, constitue une étape déterminante dans la bonne direction.

L'Afrique doit faire entendre sa voix sur la scène économique mondiale en vue de mobiliser l'attention sur les obstacles qui depuis longtemps entravent son développement et saisir les opportunités qui se présentent dans la conjoncture actuelle. Bien que de nombreux pays africains dépendent de l'accès aux financements accordés à des conditions préférentielles par les IFI, ils ne disposent que des voix marginales dans la gouvernance desdites institutions. L'architecture financière et économique internationale actuelle reste dominée par les grandes économies développées. Pourtant, la leçon capitale tirée des bons processus de développement dans les autres régions, particulièrement en Asie, est celle de l'importance de l'appropriation des politiques et stratégies déterminées en fonction des conditions locales et des priorités du pays, ainsi que l'engagement à les mener à bon port. Cette leçon doit se refléter dans la structure et la gouvernance des organisations internationales ainsi que lors de la prise des décisions qui ont un impacte sur l'Afrique. D'où la nécessité d'une représentation continentale et régionale au sein des principales structures internationales de politique et de prise de décisions. Il est également nécessaire d'accorder plus d'envergure aux institutions dirigées par les Africains, afin de leur permettre de participer aux débats mondiaux sur des bases égalitaires, de présenter les perspectives africaines et d'attirer l'attention sur les conséquences des décisions des institutions internationales sur l'Afrique. À cet égard, la représentation institutionnalisée de l'Afrique au G20 est une priorité.

VI. Afrique: nouveau pôle de croissance mondiale

La croissance de l'avant crise et le rebond de l'Afrique ont clairement démontré la capacité du continent à devenir un nouveau pôle de croissance mondiale. L'Afrique a changé, passant d'une région dont la croissance a été historiquement lente à l'une des régions les plus dynamiques au monde. Des changements fondamentaux ont eu lieu sur le continent, démontrant une amélioration de l'environnement économique et

sociopolitique. Les économies africaines sont désormais appelées à devenir une nouvelle source de croissance économique mondiale. Les fondements de cette croissance proviennent du renforcement de la capacité à concevoir et à mettre en œuvre des politiques efficaces, des ressources naturelles abondantes, d'une main-d'œuvre plus importante, et de l'urbanisation rapide.

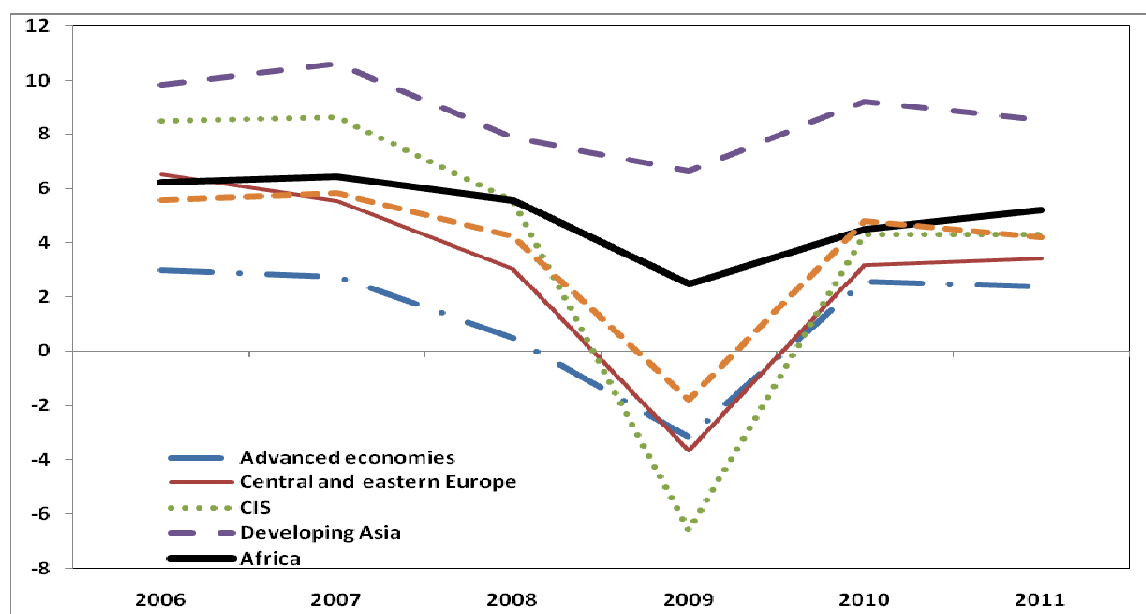
De nouvelles perceptions positives se concrétiseraient également grâce aux investissements privés, à l'accroissement des échanges, et à la croissance accélérée en Afrique. Si tous les pays africains atteignaient le taux de croissance de 7% des économies à forte croissance du continent et continuaient de croître à ce rythme, le PIB par habitant devrait doubler en 10 ans et quadrupler en 20 ans. Le PIB de l'Afrique devrait atteindre 2,6 milliards de dollars en 2020, et les dépenses de consommation s'établiraient à 1,4 milliards de dollars.¹⁹ Dans ce cas, l'Afrique jouerait un rôle important dans le rééquilibrage de l'économie mondiale, non seulement grâce aux exportations, mais également en tant que marché de grande consommation due à son importante population. L'appui aux efforts actuels de l'Afrique pour réaliser son immense potentiel économique pourrait prochainement être bénéfique pour le monde entier.

L'Afrique peut offrir une alternative à la nouvelle « normalité » de l'économie mondiale de croissance faible, de chômage élevé, d'instabilité, de niveaux de pauvreté absolue élevés, et de potentiel humain inexploité. L'histoire économique montre qu'une grande partie de la pauvreté pourrait être réduite par la croissance ; mais cette dernière doit être forte, soutenue et partagée. Si l'Afrique peut réaliser une telle croissance pendant au moins deux décennies, elle pourrait devenir une nouvelle source de dynamisme dans l'économie mondiale. En outre, bien que les marchés asiatiques continuent leur forte expansion, la Chine et l'Inde devraient augmenter leurs dépenses de consommation pour remplacer la croissance perdue par les pays développés depuis le début de la crise. Le monde a besoin d'un nouveau moteur de la demande de consommation, d'un nouveau

¹⁹ McKinsey Global Institute (2010), *Lions on the Move: The Progress and Potential of African Economies*, McKinsey Global Institute: Washington DC.

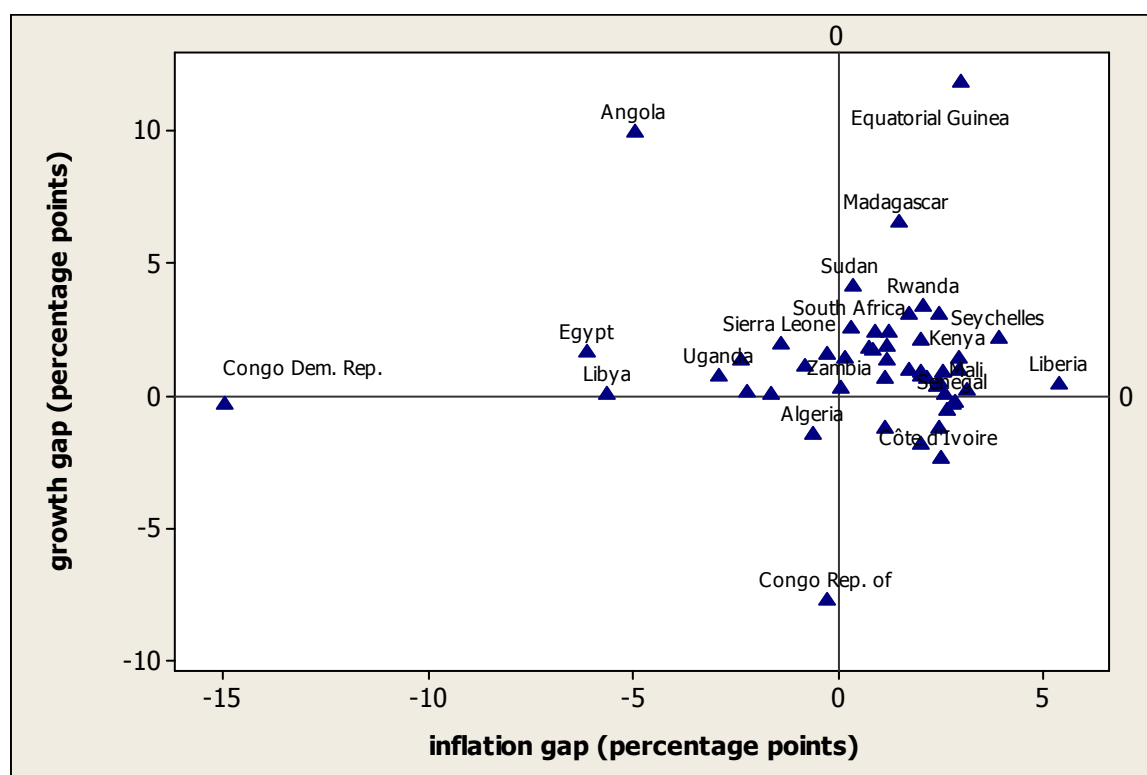
marché, et d'un nouvel alternateur, qui est l'Afrique. La croissance future de l'économie mondiale et les emplois futurs dans les pays en développement dépendront de la mobilisation à la fois du potentiel productif et de la demande de consommation inexploitée du continent. Par conséquent, tout emploi non créé, toute entreprise perdue ainsi que toute idée d'entreprise non réalisée en Afrique constituent des moteurs de croissance perdus pour le monde.

Graphique 1. L'Afrique et les autres régions : taux de croissance du PIB réel (2006 – 2011)



Sources: Perspectives économiques en Afrique et PEM, FMI.

Graphique 2. Afrique: possibilités de croître sans accélérer l'inflation 1/



Source: Calculs des auteurs à partir de la base des données de la BAD.

1/ l'écart de croissance est la différence entre la croissance potentielle (moyenne de 2006 – 2008) et la croissance réelle en 2010. L'écart d'inflation est la différence entre l'inflation cible/la tendance de l'inflation (moyenne de 2001 – 2008) et l'inflation réelle en 2010. Dans les cas où la tendance de l'inflation était de moins de 5%, l'inflation cible était fixée à 5%. Dans le même ordre d'idées, lorsque la tendance de l'inflation était supérieure à 10%, l'inflation cible a été fixée à 10%. Un écart de croissance positif signifie que le pays doit avoir pour objectif un taux de croissance supérieur ; un écart d'inflation positif signifie qu'il pourrait tolérer un taux d'inflation élevé, en particulier en ce qui concerne les pays à faible revenu affichant un taux d'inflation inférieur à 5% .

Achieving Strong, Sustained and Shared Growth in Africa in the Post-crisis Global Economy¹

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INTRODUCTION

The aftermath of the global financial and economic crisis, which Africa weathered well, presents a unique opportunity to rethink the continent's economic strategies. The key question that arises in this context is 'what should be Africa's agenda for poverty reduction beyond the MDGs?' Given the continent's vast economic potential, the agenda should focus on building a prosperous Africa. The way to achieve this is through economic growth, which is strong, sustained and shared. In that context, Africa's economic strategies need to take into account the rising importance of Brazil, Russia, India, China, Turkey, South Korea, and South Africa, as sources of trade, investment and increasingly also knowledge sharing. A related question is then how African countries can best position themselves in this new global order to achieve strong, sustained and shared growth.

To shed light on these issues, the African Development Bank, the C-10, the UNECA, and the AUC undertook a joint study in collaboration with the Korea Institute for International Economic Policy. The study highlights the key challenges that Africa faces to reach strong, sustained and shared growth. It provides evidence on the impact of the crisis and discusses longer term trends, gives examples of good international practices in selected areas, makes policy recommendations, and suggests concrete actions for the way forward. The aim of this paper is to contribute to promoting Africa's voice on development globally and especially in the debates at the G20. The paper includes specific Proposed Actions to the G20, notably: an infrastructure project development initiative, an investment-enabling legal facility, and a catalytic investment portfolio guarantee fund.

The main message that the study aims to convey is that while Africa still faces enormous challenges, its economic potential is immense. The study then suggests some ways that would help Africa turn this potential into tangible achievements. It first reviews Africa's strong pre-crisis economic performance, continued prudent policies that the continent adopted during the crisis, and an unexpectedly fast and strong rebound. It underscores that going forward, macroeconomic policies need to shift from overemphasizing stability to focusing on growth. In the following section, the study identifies the following areas that, if addressed, would help Africa achieve strong sustained and shared growth: (i) making finance inclusive; (ii) making the most out of globalization through managing capital flows and trade linkages; (iii) building strong human capital base; (iv) moving the composition of production and employment toward high value-added activities; (v) building modern infrastructure; (vi) embarking on the green growth path; (vii) amplifying Africa's voice in the global economic arena. If undertaken, reforms in these areas – together with continued adequate and timely support from the G20 and development partners -- would facilitate Africa's growth take off. And if that were to happen, specifically if Africa could grow at 7 or more percent for the next two decades, the continent would emerge as a new and additional global growth pole. A prosperous Africa would be beneficial to the entire world.

Another key message is that while Africa due to its delayed take-off can draw on good practices from other developing regions, it also has – and increasingly so -- its own good policies to share with others. Examples include the effective response to the crisis, where Africa resisted protectionist tendencies and also continued with overall prudent macroeconomic stance. Another area where Africa can be proud of its achievements is the innovative application of ICT such as m-banking (Kenya), m-agriculture (Niger, Senegal), and in general rapid adoption of the mobile technology. Finally, already prior to the crisis Africa has markedly built up its capacity to design and implement good economic policies. So

when the financial crisis hit, African countries showed leadership. With the support of the African Development Bank, UNECA and AUC, Africa drew on this capacity and swiftly created the Committee of Ten African Ministers of Finance and Central Bank Governors (C-10) to provide the continent's views on key economic issues. Now that Africa has been rebounding, the C-10 has also shifted its focus from crisis responses to policies that would facilitate strong, shared and sustained growth – the main theme of this study.

The study is organized as follows. Following the Introduction, Part I maps out Africa's economic situation in the aftermath of the global financial and economic crisis and discusses pro-growth policies for the next decade. Part II discusses major issues for Africa's development, while Part III discusses alternative models for Africa become another global growth pole. Key policy messages and the way forward are in Conclusions.

PART I. BEYOND THE CRISIS: PRO-GROWTH ORIENTED MACROECONOMIC POLICIES¹

I.1. The Crisis and the Recovery

I.1.1. High pre-crisis growth, but more is needed

Africa's GDP grew by 5.6 percent during 2001-08, compared to only 2-3 percent during the previous two decades. Prior to the crisis, Africa grew faster than most other regions. The growth was broad-based, with about 40 percent of the countries growing on average by 5 percent or above per year.

A combination of factors contributed to Africa's impressive growth performance. Prior to the crisis, Africa was experiencing booming conditions, with buoyant export revenues and increased capital inflows as global investors faced low interests at home and were searching for new sources of profit. In addition to supportive external environment and debt relief, domestic factors such as reduced conflict, greater political stability, and prudent macroeconomic policies underpinned the continent's growth. A number of African countries undertook key structural reforms that improved the business environment (e.g., Rwanda, Ethiopia), the financial sector (Nigeria), administration, and governance (Sierra Leone). Some also further opened up their economies to trade and investment.

Africa's high growth during 2001-08 was a positive turnaround, but only about 25 percent of low-income countries (LICs) grew at 7 percent or more a year during this period. At the same time, about 40 percent of the countries had inflation below 5 percent while 75 percent of the countries had inflation below 10 percent (Figures A.1.a and A.1.b). In contrast, in the 1990s only 45 percent of LICs had inflation below 10 percent. Some countries slashed their rates markedly from mid-double digits to low-single digits (e.g. Guinea Bissau) or further consolidated their stabilization gains by moving from high single digit to low single digit inflation rates (e.g., Cape Verde, Republic of Congo).

Yet in most cases very low inflation rates (below 5 percent) are not appropriate inflation targets for Africa's LICs. Empirical evidence shows that for LICs inflation hampers growth only if it exceeds a certain threshold (typically between 10 - 20 percent); below this threshold the positive impact of reduced inflation on growth is insignificant. Moreover, it is

¹ This section contains case studies on (i) fiscal policy experience of South Africa and (ii) monetary policy experience of Kenya. They are issued in a standalone Annex, together with Korea's experience with capital flows management; the Annex is available upon request.

recommended that to avoid unintended contractionary effects in the event of shocks, LICs should not aim at inflation below 5 percent.² At the same time, once inflation is stabilized at low level and expectations adjust, faster growth may be achieved without raising inflation.

The overall low inflation before the crisis and the growth rates suggest that macroeconomic policy on the continent was too focused on stabilization and not enough on raising growth and living standards. One lesson of the pre-crisis experience is that countries with currently higher (above 10 percent) inflation and lower (below 6 percent) growth (e.g., Malawi, Zambia) may have room to stimulate growth while keeping the inflation in high single digits.

Africa's growth of GDP per capita was lagging that of most other regions before the crisis. The income gap between Africa and the advanced economies narrowed only marginally in the past decade, with Africa's per capita GDP amounting to only less than 10 percent of per capital GDP in the European Union. Subsequently, the gains in income poverty reduction, especially in sub-Saharan Africa (SSA) were modest – 73 percent of the SSA population was still living on less than 2\$ a day in 2005, almost unchanged from 76 percent in 1990.³

Moreover, large differences in growth rates persisted among subgroups and countries. For example, oil exporters grew faster than oil importers (Figure A.2.a) and also achieved positive fiscal and current account balances (Figure A.2.b). A growth gap emerged between resource poor fragile countries (e.g., Burundi, Central African Republic) and the frontier market economies (Figures A.3.a and A.3.b).⁴ The low growth in Africa's resource poor fragile countries suggests that in addition to utilizing aid effectively, these countries need to implement key structural reforms to restore investor confidence and generate peace dividends.

1.1.2. 2009 was a challenging year for Africa

In 2009, Africa's high growth was interrupted by a severe external shock in the form of the global financial and economic crisis. Several exceptions aside (mostly emerging market economies such as South Africa), the impact through the financial channels of transmission was weak given the continent's limited financial integration and low level of cross-border lending (most lending by African banks is deposit-based).⁵ Also, the resilience of African countries, especially the middle income ones, to external financial shocks increased in the run up to the crisis; it was much higher than prior to the last global recession in the early 1990s.⁶

² Nigeria is a good example in this regard. With current (August 2010) inflation above 10 percent, the Central Bank aims reducing it to 9.5 percent but not lower, stating that growth is the key priority. Empirical evidence supports for LICs to keep inflation between, say, 5 and 10 percent, but not necessarily lower (IMF, 2005).

³ Similarly, about 50 percent of the SSA population was still living on less than 1.25\$ a day in 2005. As Ravallion (2008) pointed out: "...in 1981 China's poor outnumbered Africa's by almost 4:1. Yet by 1996, SSA had overtaken China in the total count of the poor."

⁴ Frontier market economies are countries that improved their economic fundamentals and accessed or about to access international capital markets. In this paper, they include Cape Verde, Ghana, Kenya, Mozambique, Nigeria, Senegal, Tanzania, Uganda, Zambia. See Deutsche Bank Research (2009) for discussion.

⁵ Some countries (e.g. Nigeria) saw their trade credit lines dry up.

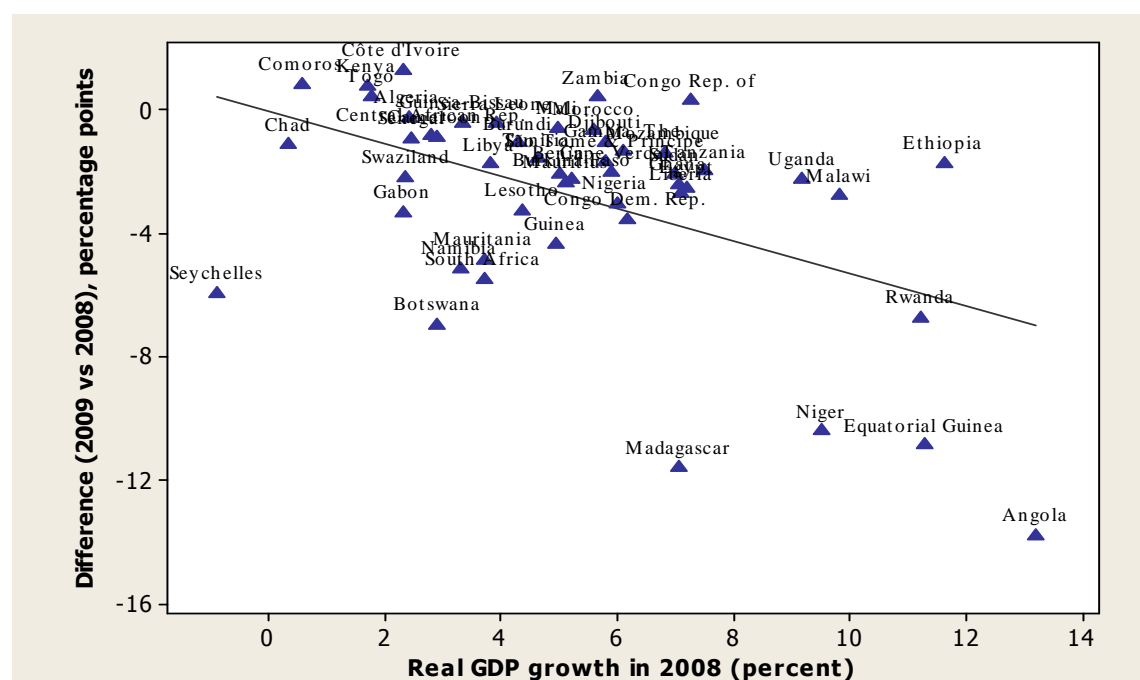
⁶ Due to low cross-border lending, even countries with strong foreign bank presence have not accumulated large external private sector debts (denominated in foreign currency). Hence they avoided deterioration of net investment positions and a currency crisis. The absence of housing finance and real estate markets has implied an absence of a key mechanism that amplified the financial shocks in other regions.

While shielded from the crisis through financial channels, most African countries were hit hard through the real channels such as declining exports and FDI and in some cases also aid, remittances and tourism receipts. Subsequently, in 2009 most key macroeconomic indicators deteriorated. The real GDP grew on average by only 2.5 percent, but the performance varied from 6.8 percent decline (Seychelles) to 9.9 percent growth (Ethiopia). The impact on SSA was severe, as growth collapsed from an average of 6.1 percent during 2001-08 to 1.6 percent in 2009. Since the crisis was an external shock, the countries that were more open to trade and grew faster before the crisis experienced larger growth falls in 2009. Correspondingly, they are expected to recover the fastest, alongside the global revival (Figures 1.a and 1.b below).

Regarding other key macroeconomic indicators, the curtailed demand in the advanced economies and lower commodity prices led to marked deterioration of trade and current account balances; oil exporters took a particularly heavy hit. A number of countries experienced ‘twin deficits’, as worsening current account balances were accompanied by rising fiscal deficits; no marked reversal occurred in 2010 except for oil exporters (Figure A.4.a). In low income countries in general and (resource poor) fragile states in particular, the deterioration of the current account balances to high levels raises concerns about maintaining hard-won debt sustainability over the medium term (Table A1).

The crisis, which was not at all of Africa’s own making, had other dire consequences for the continent, such as slowdown in progress with poverty reduction. ILO’s estimates of the impact of the crisis on working poverty (i.e. people living on less than 1.25 dollar a day) range from stagnation (at about 52 percent of all working population) to an increase of about 15 percent in 2009, which would reverse the recent gains and bring the working poverty rates back to 2003 levels. Unemployment in Africa is also estimated to have increased markedly, by about 1 – 4 million people between 2008 and 2009. Specific examples include the mining sector in Zambia where 28 percent of jobs were lost already in 2008, while the manufacturing sector in South Africa shrank by about 20 percent in 2009.

Figure 1.a. Fastest growing countries in 2008 declined the most in 2009 1/



Source: African Economic Outlook and authors’ calculations. 1/ Correlation coefficient -0.489 at 1 percent significance level.

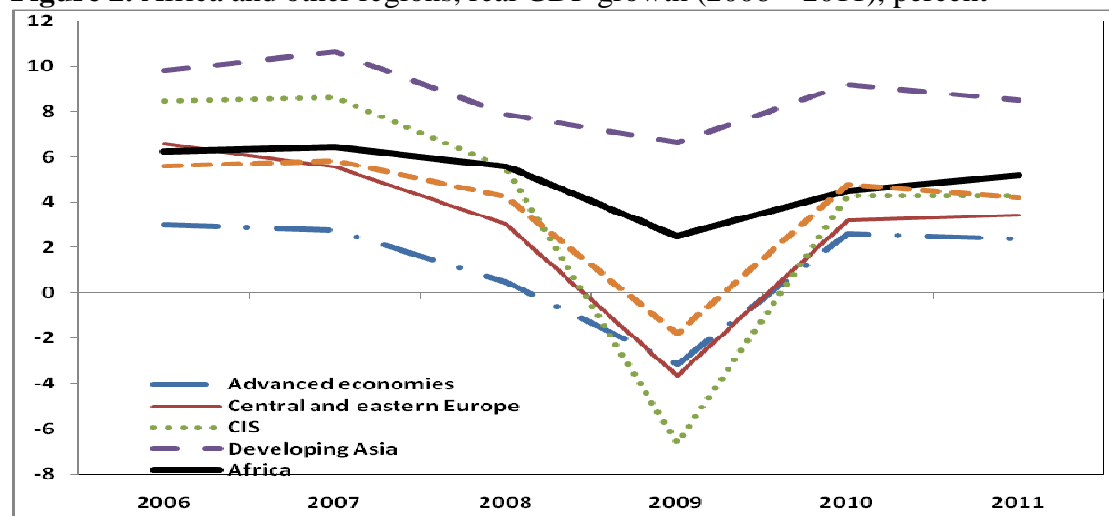
The scatter plot displays the relationship between Real GDP growth in 2009 (percent) on the x-axis and the Difference (2010 vs. 2009) in percentage points on the y-axis. The x-axis ranges from -5 to 10, and the y-axis ranges from -4 to 12. A negative linear regression line is shown, indicating that countries with higher real GDP growth in 2009 generally experienced a smaller increase in their percentage point difference between 2010 and 2009.

Key countries labeled on the plot include:

- Seychelles
- Botswana
- Angola
- Mauritania
- Madagascar
- South Africa
- Guinea
- Chad
- Swaziland
- Equatorial Guinea
- Congo
- Libya
- G.D.R.
- Liberia
- Congo Rep. of
- Ghana
- Uganda
- Malawi
- Ethiopia

1.1.3. Africa's recovery in 2010 and 2011 needs to be supported by appropriate policies

Figure 2. Africa and other regions, real GDP growth (2006 – 2011), percent



6

Several factors have helped Africa weather the crisis relatively well, especially: (i) cautious macroeconomic policies adopted across many countries prior to the crisis; (ii) appropriate counter-cyclical measures were adopted where feasible (East Africa), focusing mostly on removing supply-side bottlenecks (infrastructure); (iii) increased trade and investment linkages with Asia and other emerging market countries; and (iv) in some sub-regions (East Africa), more intensive regional integration also played a positive role. The counter-cyclical policies in particular constituted a welcome deviation from the past pro-cyclical stance. In that context, timely financial support from the multilateral financial institutions, including the African Development Bank, also helped prevent large pro-cyclical cuts in fiscal expenditures.

Nevertheless, as the recent turbulence in Europe and downward growth revisions in the United States showed, the global recovery remains fragile and the earlier risk of slower global recovery has materialized. Accordingly, risks surround also Africa's recovery, mainly through trade and investment linkages with Europe and the United States. On a positive side, countries with intensive trade linkages with China and India (e.g., Angola, Namibia, Gabon, Benin) could receive extra stimulus from Asia's robust recovery.⁷ Regardless of these opposite trends, the re-priced risk associated with emerging and frontier markets may be raising Africa's cost of capital over the medium term, with possibly negative implications for the continent's potential growth. As the investors' attention shifts from market signals to the quality of policies, African countries would benefit from adopting even better policies and communicating them effectively to partly offset the perception of being 'higher risk'.

When designing their exit strategies from the crisis intervention policies, African policymakers need to take the uncertain global recovery into account. To prevent stop-go policies, exits from crisis interventions should be gradual and well coordinated, both across countries and policies. According to the African Economic Outlook projections, about 40 percent of countries will experience higher fiscal deficit in 2010 than in 2009, suggesting the continent should not aim for quick exits (AfDB and OECD, 2010). Clearly, policies aimed at short-term stabilization are not sustainable over the medium term as they would jeopardize hard-won debt sustainability and undermine investor confidence. However, in light of the weak global recovery, where feasible, African governments may want to maintain somewhat accommodative policies also in 2011, while gradually refocusing on medium term objectives. Such approach would raise predictability and help Africa reach strong, sustained and shared growth.

Given the overall case for gradual exits from accommodative policies, the key question is how much policy space African countries have to pursue this stance in 2011. The continent absorbed the global economic crisis well, but the impact was varied. In some countries (e.g., Swaziland, Cape Verde) the crisis has reduced the fiscal policy space by raising deficit and financing it through debt. In others (e.g., Ghana, DRC) inflation accelerated, cutting the room for policies to stimulate aggregate demand. Finally, in spite of overall sound levels, in some countries (e.g., Chad, Malawi) international reserves declined to precarious levels (Figure A5).⁸

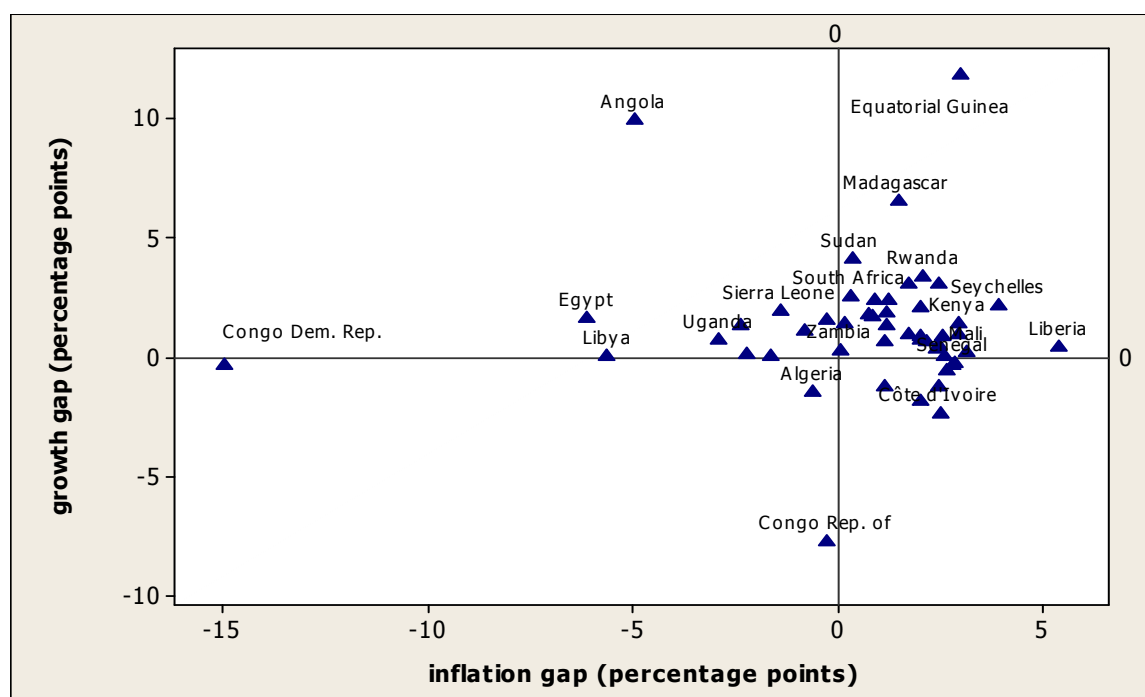
⁷ China-Africa trade represents close to 10 percent of continent's exports and imports (Osei and Mubiru, 2010).

⁸ For example, Chad's reserves collapsed by almost 50 percent between 2008 and 2009, from 3.8 months of imports to about 2 months. Similarly, Malawi's international reserves declined by 35 percent and stood at mere 2 weeks of imports in 2009 (down from 1 month in 2008).

While the fiscal situation deteriorated in a number of countries (Figures A.6.a and A.6.b), most have emerged from the crisis with stronger fiscal positions than the advanced economies. Many of the countries hit hard in 2009 were oil or mineral exporters who are expected to rebound in the near term. A few exceptions aside, debt sustainability has not been so far a major concern, even though the problem may arise over the medium term unless the current stance is reversed. Given that in 2010 (and even 2011) many countries are projected to grow below their trend growth, the key policy challenge is to bring them on a path of strong, sustained and shared growth. Often, the countries underperforming on growth are overperforming on inflation -- with inflation rates either below 5 percent or within 5 -10 percent, but below their trends (Figure 3). In these cases, countries should not avoid stimulating aggregate demand for the fear of slightly raising inflation.

The above factors suggest that growth should be the key macro priority even in the near term for most African countries, especially LICs. For those with ‘room to inflate’, inflation is not a priority right now as moderate increase can be reversed later, once high growth is restored. Still, with deteriorating fiscal and current account deficits, fiscal policy needs to ensure that any ‘extra’ public expenditures are pro-growth oriented. As in 2009 and 2010, African countries should thus focus on increasing infrastructure outlays, which alleviate supply-side bottlenecks and stimulate medium-term growth while raising short-term aggregate demand. Building social safety nets will ensure that in the future the most vulnerable segments of the population are protected and growth is shared. A positive effect would be also the creation of automatic fiscal stabilizers on the expenditure side, now missing in most African countries.

Figure 3. Africa: room to grow and room to inflate 1/



Source: African Economic Outlook and authors' calculations. 1/ Growth gap is calculate as the difference between the potential growth (average of 2006 – 2008) and the actual growth in 2010. Inflation gap is calculated as the difference between the targeted/trend inflation (average of 2001-2008) and the actual inflation in 2010. In cases where inflation trend was below 5 percent, target was set as 5. Similarly, where inflation trend was above 10 percent, target was set at 10. Positive growth gaps mean that countries should aim at higher growth; positive inflation gap means that there may be some room to inflate, especially for low income countries with inflation below 5 percent.

In reversing the accommodative policies, where feasible, Africa countries should not rush, but opt for exits that are gradual and orderly. Many countries may want to start with fiscal consolidation, even though it may be technically and politically more complex than monetary tightening.⁹ In LICs, another reason for starting with the fiscal consolidation is the weak transmission mechanism of the monetary policy, as demonstrated during the past crisis.¹⁰ At the same time, African policy makers need to ensure that important social outlays as well as public expenditures on infrastructure remain protected.

Finally, it remains undisputed that the global crisis has caused significant, and possibly long-lasting collateral damage to African economies, which needs to be resolved through a global partnership. The actions of African countries need to be supplemented by measures taken by developed countries, including provision of adequate and timely financial assistance. Without such support, the social consequences of the crisis could reverse the achievements in terms of higher growth, greater macroeconomic resilience, and some poverty reduction recorded over the past decade. The international community thus needs to listen to Africa's voice on the key strategic issues and continue to work in partnership with African countries to ensure coordinated and smooth exit from the most severe global recession of the past 60 years.

1.2. Pro-growth macroeconomic policies for the next decade

1.2.1. Shifting from crisis response to supporting growth

With Africa rebounding, objectives of macroeconomic policy have shifted from containing the crisis to stimulating medium-term growth and job creation.¹¹ The key lessons from the crisis are that *macroeconomic frameworks need to be more flexible while maintaining credibility*. On the fiscal side, pro-cyclical policies need to be replaced by rule-based and counter-cyclical fiscal frameworks that still leave room for discretion in case of unexpected shocks. On the monetary side, where conditions allow, consideration should be given to more flexible inflation targeting (IT) frameworks, which of course need to be accompanied by flexible exchange rate regimes.

Specifically, phasing out pro-cyclical fiscal policies that prevailed in the run up to the crisis would help achieve strong, sustained and shared growth and reduce output volatility. African countries could aim for balanced budgets (after grants) over the cycle. Given the need to raise efficiency of public spending and maintain debt sustainability, annual budgets should be anchored in medium-term expenditure frameworks; if set in nominal terms rather than as shares of GDP they would play a counter-cyclical role. Donors could support these frameworks by giving adequate official aid in a timely manner. To avoid pro-cyclical fiscal cuts in downturns, African governments need to improve their access to debt financing.

⁹ Moreover, as fiscal consolidation would reduce aggregate demand, continued accommodative monetary stance would be possible without fueling inflation (Brixiova, Kamara, Ndikumana, 2010).

¹⁰ In spite of lowering of policy rates, growth of money supply and especially real credit to the private sector declined markedly in 2009.

¹¹ In particular, going forward policy priorities should not overemphasize very low inflation at the cost of growth, as was sometimes the case before the crisis, particularly in low-income countries.

Developing efficient local government bond markets is thus crucial, together with gaining access to international bond markets on more competitive terms.¹²

As the increasingly globalized economy requires quick responses to shocks, there has been a world-wide trend towards more flexibility in monetary and exchange rate regimes.¹³ Among monetary policy frameworks, flexible inflation targeting (IT) has become increasingly popular all over the world during the past decade. Some African countries already adopted inflation targeting (IT) framework (e.g., South Africa, Ghana), others are planning to do so in the medium term (e.g., Kenya, Uganda). The crisis has reiterated the need for flexibility in macroeconomic frameworks and brought the option of adopting flexible IT frameworks back on the top of macroeconomic policy agenda.¹⁴ Another lesson from the crisis was that monetary policy should aim at price stability over the long-term, but not over react to short term deviations from inflation targets, especially at times when output growth is below the potential.

Recent global developments showed the negative effects that freezing up of credit can have on growth. As the view that in developing countries monetary policy affects output mostly through the credit channel has gained acceptance, African central bankers have increasingly focused on credit as the key part of the monetary transmission mechanism. The crisis has also shown that in Africa cuts in policy rates do not necessary increase credit to the private sector, pointing to structural rigidities and inefficiencies in financial systems. With these impediments, private sector alone will not be able to drive Africa's near-term recovery; effective state interventions will be needed.

1.2.2. Private sector development and industrial policy

African policy makers have recognized that for growth to be sustainable over the longer term, it needs to be underpinned by a vibrant private sector. At the same time, in spite of efforts to undertake structural reforms and deregulation, the formal private sector in Africa remains limited, exhibits low levels of productivity and is highly concentrated in natural resources and primary production. The recent global economic crisis increased the attention of African policymakers on the need to shift from development driven solely by markets to the balance between the market and the state. The government has a role to play also in private sector development beyond deregulation, through learning, industrial and technology policies.¹⁵

¹² Kasekende, Brixiova, and Ndikumana (2010) discuss the counter-cyclical fiscal policies adopted by African countries during the crisis.

¹³ In 1970s, 90 percent of all countries had fixed exchange rate regimes; in 2000 less than 30 percent of countries. In Africa, the share of countries with flexible regimes has also increased over time. This is to some extent to be expected – as economies mature, the value of exchange rate flexibility rises (Rogoff, et al. 2003). According to the IMF classification, 44 countries out of 192 practiced formal inflation targeting as of April 31, 2008, up from 19 countries (among 187) that had this regime in 2003. Some countries target inflation informally.

¹⁴ Weeks (2010) explains why monetary targeting is ineffective in SSA -- as bond markets are under-developed, open market operations do not work. Khan (2010) discussed the evolution of monetary policy frameworks in sub-Saharan African. Heintz and Ndikumana (2010) discussed constraints that need to be addressed for the flexible inflation targeting to become effective and for central banks to play a greater development role.

¹⁵ Stiglitz (2010) covers the main elements of learning, industrial and technology policy.

The crisis has also underscored the importance of export diversification to mitigate adverse external shocks. Africa's past experience suggests that lowering barriers to competition alone is not enough. Also, rather than picking winners, policymakers need to design industrial strategy to identify high-potential export sectors. Specifically, the industrial policy should target sectors that are: (i) 'nearby' (requiring capabilities similar to those in current production so as to increase economic density); (ii) relatively sophisticated (raising the level of technology); and (iii) facilitating exports of other sophisticated products (having strategic value).¹⁶ In this regard, the oil sector can be particularly challenging to leverage for export diversification because it uses a specific set of skills, often completely different from other existing activities (e.g. Algeria). In such situations, industrial policy should aim at 'rising product density' through providing the necessary public goods for the nearby sectors while removing barriers to their operations.

Developing the private sector in fragile states requires particularly pro-active approach. In these countries enabling investment climate is a necessary but only one condition for private sector development. Since fixed costs of entering new activities and niches in these countries are particularly high, government interventions are needed to connect the missing links. Hence the focus of this new industrial policy should not be on picking winners, but rather on stimulating the discovery process in high-potential industries and sectors and providing supporting institutions as needed. Given the small size of markets in many fragile states, where feasible (e.g., Burundi, Rwanda) private enterprises should seize opportunities from the regional integration and become part of regional and global value chains.

1.2.3. Preparing for the next crisis

a. Building social safety nets to assist the most vulnerable

The recent global financial crisis has shown the importance for Africa to create mechanisms in Africa to protect the most vulnerable segments of population against unexpected shocks. The need for social safety nets was also demonstrated in 2008, when unrests erupted because of rising food prices in several African countries (e.g., Egypt, Senegal, Somalia, Cote d'Ivoire). While in most African countries, social spending was preserved during the crisis, in some (Nigeria) it was cut. The low coverage of the programs reminded of the importance to create more robust nets before the next crisis hits. As the global financial crisis has turned into the job crisis, countries throughout Africa have realized that more attention should be paid to public works programs, especially where labor-intensive infrastructure building is involved.

In addition to short-term social safety nets, well-targeted longer term protection programs would support shared growth.¹⁷ In practice, a key obstacle to reforming social safety nets is the limited knowledge of the existing ones and in particular of prevailing good practices. Closing this knowledge gap and utilizing good practices from other developing regions will go a long way to reducing vulnerability and improving well-being of people in Africa.

b. Mobilizing resources to increase resilience

¹⁶ Hausmann, Klinger and Lopez-Calig (2010) illustrate this approach for Algeria, a country characterized by particularly low level of export diversification.

¹⁷ The African Union adopted in 2008 a social policy framework for Africa to strengthen social protection systems, combat hunger, create decent work opportunities for all, and improve access to basic social services.

Given the low domestic savings that characterize African countries, especially those in Sub-Saharan Africa, most countries face significant resource gaps. Financing options for closing them include mobilizing: (i) domestic resources, both public and private; (ii) official aid; and (iii) private capital flows.

Effective ways to raise domestic tax revenues (public savings) – in particular broadening of the tax base through strengthening tax administration and formalizing the informal sector – should be pursued further as feasible. It is less clear how to raise private savings, and methods vary from country to country. In addition to the banking sector reforms, some innovative ways such as leveraging the local wealth (land, houses) or securitizing future flows (remittances, oil revenues) are being explored (e.g., Ghana).¹⁸

As measures aimed at domestic resource mobilization will take time to implement, many African countries, especially the LICs, will rely on aid to supplement their resources. To be effective, donors need to provide aid on a timely, predictable and sustained basis. On their part, countries need to ensure that the increased reserves due to higher aid are not just sitting idle. Moreover, a substantial part of aid received should finance domestic investment.

Nevertheless, given the substantial development needs to reach the MDGs, especially when combined with the climate change financing needs, domestic revenue mobilization and foreign aid will not be sufficient. Countries will need to increasingly rely on private-public partnerships and private capital flows (below). In this context, it needs to be emphasized that debt sustainability and development objectives need to be carefully balanced to achieve strong, sustainable and shared growth. In particular, a greater flexibility of the IFI's debt sustainability framework agreed at the end of 2009 is a step in the right direction.

Box I. Macroeconomic Policies for Strong, Sustained and Shared Growth –Actions

A. Actions by African countries

1. *Exit strategies from the crisis interventions*

- Where feasible, African countries should not rush, but opt for exits that are gradual, orderly and coordinated among countries and policies.
- Many countries may want to start with fiscal consolidation which can be more politically complex, followed by the withdrawal of accommodative monetary stance.
- Expenditures on infrastructure and social services should be protected even during the fiscal consolidation phase.
- African policy makers need to communicate their policies effectively to the public to reduce uncertainty, gain political support, and boost investor confidence.

¹⁸ High levels of capital flight, including illicit outflows, continue to impede efforts to raise domestic savings and should be reversed. On the positive side, in the run up the crisis the outflows declined due to improved macroeconomic stability and the business environment and hence the reassessment of risk-adjusted returns.

2. *Macroeconomic policies for the decade ahead*

- Increasing flexibility of macroeconomic policy frameworks while maintaining their credibility by introducing rule-based frameworks with sufficient room for discretion.
- On monetary policy side, this implies moving towards flexible inflation frameworks where conditions allow (e.g., frontier market economies); all countries may want to pay more attention to the private sector credit as a key transmission mechanism.
- Removing pro-cyclical bias of fiscal policy by balancing budget (after grants) over the medium term. Introducing or strengthening medium term expenditure frameworks.
- Exploring and introducing new industrial policy to facilitate the private sector growth, which is an important source of growth over the medium term.
- Building social safety nets, including public work programs, before the next crisis hits and to reduce probability of its occurring.
- Mobilizing resources to build resilience including through financial sector development and also innovative mechanisms such as leveraging remittances and future oil revenues. Adapting to local conditions the best practices in these areas from other regions, such as Asia or Latin America.

B. *Actions by G-20 countries and other development partners*

- Withdrawal from stimulus policies in advanced countries need to take into account impacts on Africa. Protectionist measures introduced during the crisis should be abolished and long-standing barriers (agriculture) removed to help Africa's exports recover.
- As feasible, scale up official aid in line with the 2005 commitments. Abolish the stop-go patterns of the past and deliver adequate aid in timely and predictable manner. Financial aid in new priority areas (climate change) should not crowd out other development needs.
- Asian countries could share knowledge in policy areas such as industrial policy while taking into account specific conditions of African countries.

PART II. MAJOR ISSUES FOR AFRICA'S ECONOMIC DEVELOPMENT

II.1. Towards inclusive finance

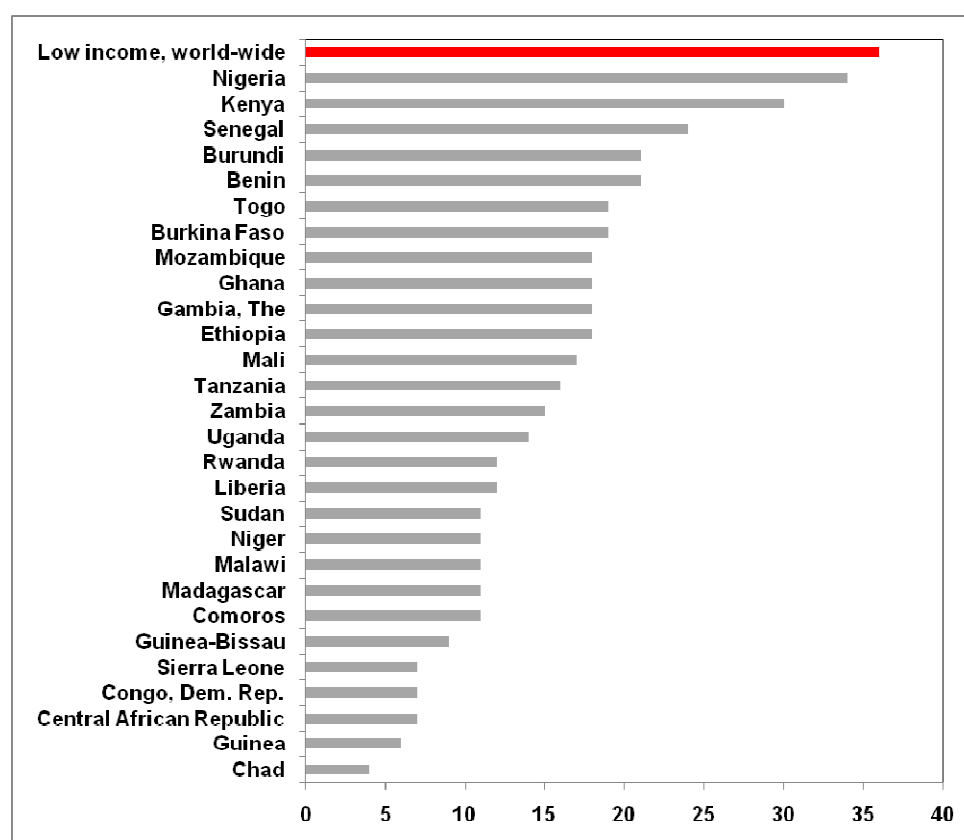
The state of development of the financial sectors in Africa varies greatly across countries. While the financial sectors in LICs are among the world's least developed, in middle-income countries they are much larger and have a broader institutional coverage.¹⁹ The limited depth and breadth of the African financial sectors in LICs has been hindering their development. Albeit increasing in some African LICs in recent years, credit to the private sector in terms of GDP has remained low, even in comparison to LICs worldwide (Figure 4). For instance, the constrained rural credit contributes to the low productivity in agriculture, while the inadequate access to finance by SMEs impedes private sector development in industry or high-value

¹⁹ IMF (2006) covers the pre-crisis challenges of financial sectors in sub-Saharan Africa in detail.

added services. In 2009, about 326 million (or 80 percent) adults in sub-Saharan Africa (SSA) were unbanked, i.e. they did not use formal banks or semi-formal banking institutions to save or borrow. In addition to those financially excluded, many of those with some access to financial services remain underserved.

While demographic and socio-economic factors matter, they are not the only determinants of the usage of financial services. Other factors, such as enabling regulatory environments, effective policy actions, and well-targeted and pro-active approaches of financial institutions can raise levels of financial inclusion (Chaia et al., 2010). For African policy makers and multilateral financial institutions, bringing the unbanked into the formal financial sector and increasing their access to credit then pose an important challenge, which was only exacerbated by the global financial crisis (Mafusire and Kamara, 2009).

Figure 4. Credit to the private sector in Africa's low income countries, % of GDP, 2008 1/



Source: World Bank Development Indicators. 1/ 2006 for Ghana; 2005 for Rwanda and Guinea.

Due to the limited integration into the international financial markets, the global financial crisis affected Africa less through the financial channels than other regions. Macro-prudential reforms undertaken by many countries in recent years also helped the continent weather the crisis. Still, in SSA, growth of credit to the private sector fell (IMF, 2010).

Among SSA oil exporters especially, the declining export proceeds contributed to falling of foreign assets of the banking sector and a sharp decline in the growth of the private sector

credit in 2009 (Figure A.7).²⁰ These developments have slowed deepening of Africa's capital markets and reiterated the importance of diversification and financial sector development.

II.1.1.Limited access to trade finance

Despite the overall limited financial integration, several African countries (e.g., Nigeria) saw their trade credit lines dry up when the financial crisis hit. While the global trade finance situation has mostly improved with the ongoing recovery, many markets in Africa have remained under stress as of mid-2010. Despite high demand, banks tightened liquidity for countries considered to be 'higher risk' to the point that the trade credit has become prohibitively expensive, especially for small traders.²¹ Implementation of the existing capital adequacy regime has thus contributed to the drying up of trade finance. Implementation of the Basel II rules had increased the capital intensity of trade finance lending, which has constrained the banks in lending short-term trade credit. Given the inherent pro-cyclicality of the framework, the constraint has become greater during the crisis. Going forward, changes to the Basel II framework should be considered to allow more proportionate capital weightings for traditional trade finance transactions (International Chamber of Commerce, 2010).

Regardless of the crisis, for many African low-income and export-dependent countries the limited access to trade finance has continuously impeded trade and needs to be addressed.²² The evidenced-based policy recommendations and actions are constrained by the limited data, the available information suggests that in addition to multilateral trade finance programs, development of national guarantee programs would facilitate flow of trade at all times.

II.1.2. Innovative ways of financing agriculture

In Africa's low income countries, the *lack of access to rural credit and the limited range of financial services available* are often mentioned by smallholder farmers and others as the key constraint to production. In the late 1980s and early 1990s, the attempts to invigorate lending to agriculture through agricultural development banks did not yield intended results. While in the 1990s microfinance institutions and concepts such as group liability and micro-insurance helped reach the unbanked in nonagricultural areas, the progress with agricultural financing has been lagging. Since the early 2000s, new innovative approaches to financing agriculture have thus emerged, often utilizing the modern communication technology. Examples are:

- Through *mobile banking*, the Equity Bank in Kenya has slashed transaction costs and brought financial services to the previously unbanked population in some of the most isolated rural parts of Kenya. In partnership with other institutions, the Equity Bank has established a

²⁰ In Morocco, where the state-owned enterprises play a key role in the economy, the annual growth rate of credit contracted markedly between 2007 and 2009, from about 30 percent in 2007 to less than 10 percent growth in 2009, in part due to stringent banking regulations (Faye and Triki, 2010).

²¹ Even exporters from countries considered 'lower risk' were charged markedly more for endorsing a letter of credit and insurance in early 2010 than before the crisis.

²² Trade finance also helps African banks and companies integrating into regional and global trade networks in and outside of Africa, and thus facilitates knowledge sharing.

US\$50 million loan facility with accelerated access to affordable financing for farmers and agricultural value chain members.²³

- To address the very low *commercial lending to agriculture*, Standard Bank of South Africa, in partnership with the Alliance for Green Revolution in Africa (AGRA), established a US\$100 million facility to provide financing to small-scale farmers and agricultural businesses in Africa. The guarantees of these loans, provided by AGRA and the Millennium Challenge Account (MCA), are to be lowered over time.
- The Rabo Development (RD), subsidiary of Rabobank (Netherlands), invested in banks in Tanzania, Zambia, Mozambique and Rwanda with a view to provide financial services to the underserved in rural areas. RD aims at *transforming the local banks into leading banks with rural orientation*, and hence limits its participation to minority stakes (10-40 percent). Financing through RD is accompanied by technical assistance from Rabo International Advisory Services (van Empel, 2010).
- Also, new innovative ways to address the causes of under-provision of credit in rural areas, such as the asymmetric information about borrowers' intentions and ability to repay their loans, are on the way. In Malawi, *biometric technology* was used in a pilot case to reduce information asymmetries and monitor repayment rates of rural borrowers. In the study the technology increased repayment rates, with the benefits of improved repayments outweighing the costs of technology adoption. More research is required to find out whether the biometric technology can be scaled up effectively for application on a wider basis (Gine, 2010).

II.1.3. Inclusive finance for SMEs: leveraging remittances

While in advanced economies SMEs are often engines of growth and job creation, in many African countries they often operate on the margin of the economy, in low-productive activities in the informal sector. The entry barriers and the limited finance for SMEs and generally the lack of competitive pressures shield larger firms from the need to adopt new technologies and raise productivity. Subsequently, the share of SMEs in employment in African low-income countries (about 30 percent or less) is well below that of advanced economies, where SMEs account for the majority of employment.

The causes of underperformance of the Africa's SME sector are complex and often country-specific. Still, the lack of access to finance is cited by many entrepreneurs across countries as the key constraint. Lenders everywhere, and in Africa in particular, consider the SME sector risky because of SMEs' lack of credit history, a lack of collateral, higher risk of failures, and greater obscurity in their operations than in larger firms. In Africa, additional challenges stem from the flaws in legal and regulatory environments and underdeveloped capital markets. Removing the information constraints, i.e. improving available information about potential borrowers, and improving access to finance and long-term capital for SMEs would increase the rate of their start-ups as well as help expansion in the existing ones.

A range of approaches to increasing access of African SMEs to finance have been tried over the years, with mixed results.²⁴ In this context, facilitating the channeling of remittances

²³ Salami, Kamara, and Brixiova (2010) cover the alternative financing mechanisms in Kenya and South Africa in more detail.

through formal financial institutions may contribute to alleviating the credit constraint faced by SMEs. In particular, the potential entrepreneurs seeking to start SMEs can leverage remittance inflows as a substitute for collateral and credit histories. Alternatively, where stable, the inflows can be used during the risk assessment of the remittance-receiving client. This way, remittances allow the entrepreneurs to get cheaper and/or higher credit. However, as Comstock et al. (2009) point out, for this option to be implemented in practice, instruments to leverage remittances specifically for productive purposes need to be put in place. Creating framework for securitization of remittances would be particularly helpful in this regard.²⁵

In addition to the innovative mechanisms, more traditional approaches are another key for achieving financial inclusion for SMEs. They include raising competition in the financial sector and creating market-based incentives for delivery of sustainable financial access and broad range of affordable services. The property rights should be also strengthened to ease the collateral bottlenecks that hamper SME access to credit. The legal and regulatory framework should be applied even-handedly to minimize distortions.

Box II.1.1 – Towards Inclusive Finance -- Actions

Trade Finance – Actions for African countries and G20

- Improve data collection for trade finance to facilitate evidence-based policy analysis and its implementation.
- Develop national guarantee programs along side of multilateral program for trade finance.
- Increase the ability of banks to lend short-term trade credit by reducing capital intensity of trade finance in the Basel framework (for G20).

Agricultural Finance – Action for African countries and G20

- Promote utilization of modern communication methodology to overcome impediments to agricultural lending in Africa. Explore other ways for reducing transaction costs, as was done through mobile banking in Kenya and for overcoming information asymmetries, as is being investigated with biometric technology in Malawi.
- Encourage sharing of knowledge and best practices across African countries.

SME Finance – Actions for African countries

- Create framework for securitization of remittances so they can be leveraged for SME lending (as collateral or in banks' risk assessment).
- Raise competition in the financial sector and create market-based incentives for delivery of sustainable financial access and broad range of affordable services for SMEs.
- Strengthen property rights and apply the legal and regulatory frameworks even-handedly.

²⁴ Options for financing SMEs in Africa include traditional way, i.e. obtaining the bank credit, raising funds on capital markets (through corporate bonds, venture capital stock shares), and asset-based financing.

²⁵ Steps for securitization of future flows, including remittances, can be found in Kethar and Ratha (2009).

II.2. International Linkages and Regional Integration

II.2.1. International Linkages: Making the Most out of Globalization

a. Attracting private capital inflows while managing their volatility

With low savings rates, volatile export revenues, and substantial investment needs that characterized many African economies before the crisis, capital inflows were an indispensable source of financing. After years of relatively slow growth, net private capital inflows to Africa accelerated in the early 2000s and surged between 2004 and 2007, reaching almost US\$60 billion in 2007. They exceeded several times the official flows. The large inflows in 2000s made some African emerging and frontier market economies vulnerable to the risks of “sudden stops” and reversals of capital flows.²⁶

On balance, Africa’s overall financial integration remained limited. Africa was thus mostly shielded from the impact through the financial channel when the crisis hit. SSA in particular was more immune to the impact through this channel than other developing and emerging market regions, and it experienced only relatively small decline in private capital flows (Figure A.8, Annex). With FDI predominating, the continent suffered less from the global credit crunch than other regions with a large composition of portfolio flows (Tong and Wei, 2009). However, when it comes to official capital inflows, in 2009 SSA received less official capital inflows (even in relative terms) than most other developing regions, except Asia.²⁷

The limited availability of the official aid in the years ahead also underscores the importance for African countries to attract adequate private capital flows to fuel growth, while managing their volatility. Clearly, generalizations for a continent as diverse as Africa are likely to be simplistic or even unsuitable. Still, several points regarding management of capital flows in the post-crisis environment are worth highlighting.

First, capital flows to Africa have so far not reached levels comparable to those in other regions or those needed to close the resource gaps.²⁸ Hence bringing in additional – and stable – flows remains a key policy objective for the majority of African countries.

Second, in the future, as Africa’s financial integration progresses, the issue of capital flows management will gain more attention. Two basic approaches can mitigate possible negative consequences of large capital flows: (i) a flexible macroeconomic framework; and (ii) management on capital inflows and outflows.

- Africa’s resilience during the crisis illustrated the importance of building sufficient policy space in the macroeconomic frameworks to mitigate shocks. Such flexibility can be achieved through appropriate accumulation of fiscal reserves and foreign exchange reserves during the boom times as well as by increased flexibility in the exchange rate regimes.

²⁶ Further discussion of trends in capital flows, savings and FDI as well as their impact on Africa’s economic performance before and during the crisis is in Brixiova, Kouakou and Abderrahim (2010).

²⁷ According to OECD (2010), official aid projected for 2010 will amount to less than 90 percent of what was committed in 2005.

²⁸ At the other extreme, during 1990s Peru received annual capital flows of 11 percent of GDP. Similarly, Estonia’s net capital flows amounted to 11 percent of GDP in 2006 and 20 percent of GDP in 2007.

Developing domestic bond markets and gaining access to international bond markets on favorable terms would help in this regard.

- Even if macroeconomic frameworks and policies are sound, surges in capital flows can cause problems through, for example, exchange rate overshooting or asset price bubbles. This is in part because of pro-cyclical features inherent in the Basel II system. Moreover, where investors act according to the herding behavior, ‘sudden stops’ of capital flows can occur. In such cases, targeted controls especially at short term inflows could be considered on a temporary basis to reduce volatility in the future. For countries that want to prevent “sudden stops” or abrupt capital outflows during downturn, controls on outflows can be an option.²⁹

Third, it is not clear how quickly in practice the temporary capital controls can be imposed relative to other macroeconomic policies and to what extent they may become semi-permanent. But the large disparities between the *de jure* and the *de facto* capital controls suggest that with time, capital controls lose their effectiveness as firms and individuals tend to find their way around them. This disparity points to the case for introducing capital flow controls only on temporary basis, with a clearly set exit.

b. Boosting development-friendly FDI

In the post-crisis world characterized by reduced risk appetite of investors and limited availability of official aid, the economic progress of many African countries will hinge on receiving adequate private capital flows, especially FDI. While in the past research on the impact of FDI on the host countries was often inconclusive and sometimes even controversial, more recent work has shown under what conditions FDI can be a catalyst for development.

Specifically, a competitive environment in the host country is needed for foreign investors to enhance productivity of existing activities and generate positive spillovers. Open trade and investment regimes can contribute to creation of such environment, through creating external competition and thus reducing the industry concentration. Over time, open markets and improved business environment tend to create welfare gains through re-allocating resources to their most productive use, and hence increasing productivity and growth.³⁰ However, to gain political support and mitigate the social costs of such measures, reforms in these areas should be accompanied by establishment of well-functioning social safety nets.

When designing their strategies towards FDI inflows, policy makers need to take into account that the factors driving FDI are complex and vary across countries, sectors and firms. In addition to natural resources and the market size (mostly lacking in Africa), these typically include political stability, sound macroeconomic policies, high economic growth, trade and investment openness, and high quality of institutions. Recognizing the benefits that FDI can have for their economies, in the 1990s a number of African countries introduced important policy innovations and shifted from targeting FDI for specific sector to establishing broad

²⁹ The Chilean experience showed that controls on short-term inflows distort incentives for efficient portfolio allocation and raise cost of financing for small- and medium-sized firms. Controls on capital outflows in South Africa in recent years led to real exchange rate appreciation, which reduced export competitiveness. Experience of Korea with capital account management is summarized in the standalone annex, available upon request.

³⁰ A related strand of research has shown that when FDI inflows are accompanied by increased trade, as is often the case in emerging market economies, host countries tend to accelerate their growth rates.

enabling environment. These “pull factors”, together with investors increasingly searching for new sources of profit and resources led to more FDI inflows going to Africa.

The aggregate numbers mask important differences – in 2009, the FDI inflows to China were almost twice as large as those to the entire Africa. Moreover, resource rich countries and the mineral sectors continue to receive the main share of the flows, even though in recent years some LICs such as Rwanda, Uganda, and Zambia have gained attention of foreign investors.³¹

In the light of these trends and consensus on the positive impacts that FDI can bring to the recipient economies, what can African countries, especially the LICs, do to attract adequate flows of development-friendly FDI? An empirical research suggests that some minimal threshold of development is needed for the host countries to benefit from FDI (Borenzstein et al., 1998; Alfaro et al., 2004; Wang and Wong, 2009). Put differently, if the institutional, technological and human capital gap with the investor’s country is wide, the host country will lack capacity to absorb the technological and “know-how” transfers. Efforts to raise human capital and technological capacity are crucial to attract ‘development-friendly’ FDI and reap its maximum benefits.

Moreover, since adequate domestic resources are needed to co-finance FDI projects, strengthening of domestic financial systems and capital markets to facilitate savings and credit in the host countries would help attract FDI.³² The African countries aiming to encourage intra-African FDI and maximize its benefits may want to adopt measures encouraging regional integration and trade (below). This could attract additional market-seeking FDI flows from developed economies as well.

As evidenced by the longer-term decline of the share of the manufacturing sector in GDP and limited foreign investment this sector has received, many investors still do not consider Africa as a profitable location for investments in manufacturing. Presumably, they are not sure that the expected returns would be high enough to justify the costs, especially given the high perceived risks. As for the risk factors, three of them are particularly relevant: macroeconomic instability; loss of assets due to non-enforceability of contracts; and the poor physical and technological infrastructure. Moreover, given that the African governments typically lack the financial and human resources to negotiate effectively or lack the appropriate legal frameworks, the agreed contracts are either not implemented or face high probability renegotiations. This deters private investment.

While macroeconomic frameworks and outcomes have improved markedly prior to the crisis, African countries could take a number of steps to address the other two weaknesses. Reducing transaction costs through investment in infrastructure would be one way to make African countries more attractive to investors, improving trade policy instruments another. Poor physical infrastructure, in particular, raises significantly trade costs and reduces competitiveness of Africa relative to other regions. Nevertheless, while policymakers and

³¹ The composition of FDI sources has also changed during the past two decades. While intra-African FDI flows remain overall low, they constitute an important source of investment funds in several countries, especially in Southern Africa (e.g. Mauritius). More recently, Nigeria became active investor in the banking sectors of other African countries as well as outside of the continent.

³² Aghion et al. (2009) provide theoretical framework and empirical evidence.

donors agree in principle on the need to address this bottleneck, in reality the situation will take time to rectify (Kandiero and Ndikumana, 2010).

African countries, especially LICS, would benefit from technical and financial assistance from G20 and development partners to build up their capacity to negotiate. In sum, the contracts must be perceived as fair by African countries to be durable, which so far often has not been the case, especially in resource rich countries and fragile states. Strengthening of legal frameworks would help contract implementation.

The positive impact of FDI on growth and development of host countries is unlikely to materialize unless the other participants of this process, e.g. multinational enterprises, the sending countries and the international community, implement supporting policies. For example, given that trade and FDI reinforce each other and some FDI is even contingent on trade, further trade liberalization in sending countries would be FDI-enhancing. Equally important is that sending companies take into account technological priorities of recipient countries and where feasible ‘clean’ technologies to facilitate sustainable development. As OECD (2002) points out, MNEs have a key role to play, by utilizing adequate technology, sharing knowledge, and adhering to good standards of corporate behavior.

As mentioned above, private sector investment to African countries, especially LICs, is hampered by (i) high perceived risk of investing in Africa and (ii) uncertainty surrounding the contracts between foreign investors and African counterparts. To address these bottlenecks, Africa asks the G20 to support (i) the African catalytic investment portfolio guarantee fund to reduce the investment risk and (ii) the African investment-enabling legal facility to assist African governments to acquire the necessary legal capacity to negotiate complex commercial contracts in their best interests.

c. Removing remaining barriers to trade

Given the dual linkages between FDI and trade, opening up to trade is one venue through which African countries can attract FDI and reap greater benefits from it. In addition to the FDI channel, trade openness is often considered a direct key determinant of growth and job creation, at least in the medium term. Prior to the crisis, the value of Africa’s trade (imports and exports) had broken the US\$ one trillion mark. Still, with Africa’s exports accounting for less than 4 percent of world exports and Africa’s imports for less than 3 percent of world imports, the continent’s participation in the global trade has been marginal. Reversing this marginalization in the global trade and moving Africa’s trade up on the technology ladder are then key policy challenges for both African and advanced economies.

The global economic crisis put Africa’s trade performance to the further test. Due to the lack of export diversification, African trade fell in the second half of 2008 till the first half of 2009, in response to both the collapse in commodity prices and import demand in trading partners. This was reflected in a sizeable decrease in export value of 30.9 per cent, and a slightly lower fall in import value of 19.5 per cent in 2009. The relatively less weakened import demand in Africa was driven by the fall in commodity prices which favored the net importers. On the more positive note, exports and imports are estimated to recover in 2010 at 15.3 and 11.3 per cent, respectively, driven mostly by the gradual global recovery (ECA and AUC, 2010).

Africa’s trade response to the crisis has been mostly determined by its trade bias, with approximately 80 percent of exports being oil, minerals and agricultural goods; fuels and

mining products accounting for the largest part. Further, the US and EU receive nearly two thirds of Africa's exports whilst intra-regional trade barely accounts for 10 per cent of total African trade. This lack of diversification, both in terms of export products and destinations, explains both the high volatility of African trade in recent years, as well as the strong impact of the crisis through the trade channel. As the relatively strong East African performance during the crisis illustrates, the regional integration could in part reduce this volatility (below).

In recent years, Africa has diversified its trade and investments links into Asia and other emerging market economies. Still, the growing South-South trade with Asia has remained unbalanced, with Africa's trade accounting for only about 2 percent of Asia's imports. In contrast, Asia accounted for almost 40 percent of Africa's exports in 2008. Overall, the weak diversification of African trade both in terms of products and destinations will require special focus. The Aid for Trade initiative provides an opportunity to address these challenges if infrastructure, trade facilitation and building productive capacities are well prioritized.

In the near future, the trade is expected to increase given the double-coincidence of needs (Asia needs natural resources while Africa needs manufactured goods). Over the medium term, the gradual technological upgrade in China's production will create (and to some extent has already created) space for Africa to develop its underperforming manufacturing sector. To seize this opportunity, Africa needs to remove key bottlenecks that hindered its structural transformation and industrialization in the past.

The main bottlenecks that Africa needs to remove to achieve greater and more diverse participation in the global trade and investment include: weak trade policy (high tariff and non-tariff barriers) in some key sectors (agriculture, manufacturing); supply-side bottlenecks (poor infrastructure such as road transport, rail, ports and customs); relatively weak business environment as well as barriers to competition, and other 'behind-the-border' constraints.

While conceptually straightforward, reforms to address these constraints are politically difficult to implement. This is because their costs would fall rather quickly on well-defined groups, while the benefits would be less tangible and dispersed over time and larger segments of population. Nevertheless, several countries have made progress in these areas, showing it is possible and setting examples for others.

Reaping benefits from multilateral trade linkages

The fact that after a decade of negotiations, the Doha Development Round has not been concluded is a major setback to international trade. A positive outcome in the Doha Round of international trade negotiations of the World Trade Organization (WTO) remains critical to Africa's increased participation in global trade.³³ Africa's negotiations on the Economic Partnership Agreements (EPAs) with the EU are also key. A rapid conclusion of the Doha Round and resolution of the outstanding issues in the EPAs negotiations would raise Africa's medium term prospects in both regional and international trade. Clear linkages between the Doha Round and the EPAs also need to be established.

³³ These are the most challenging regional trade agreements, given the inclusion of LDCs in African sub-groups negotiations, the reciprocal nature of trade relations, the burdens such relations pose on Africa's regional integration and industrialization agenda, achieving compatibility with WTO regulation without washing down African preferences, as well as the limitations on South-South cooperation.

II.2.2. Moving ahead with Regional Integration

a. Maximizing benefits, mitigating costs

For more than four decades now, regional integration has been at the centre of Africa's development vision.³⁴ It would help African economies to diversify and build up protection against external shocks. It would also bring about substantial benefits due to the economies of scale. Coordinated macro-economic policies, enhanced flexibility and the collective exploitation of resources, all preconditions for successful regional integration, could go a long way towards finding new sustainable growth paths that many African countries need.

On the more cautious side, the prevailing lack of resource and production complementarities between many African countries limits both intra- and extra- regional trade. Without integration though, most countries risk to remain dependent on the world economy as producers of primary commodities and importers of manufactured goods.

At the same time, regional integration generates not only benefits, but also substantial costs, especially during the transition period, which make it essential that countries assess the prospective benefits and costs of the process carefully. So far, concerns about unequal distribution of benefits of integration and polarization of the process around the larger anchor countries have gone unaddressed. Integration programs have no provisions for handling possible imbalances in neither economic benefits, nor are there compensation mechanisms (excepting a few examples) for losses to government revenue that could arise from trade liberalization. To be effective, regional integration strategies should include a transparent, equitable, rule-based system for sharing gains and resolving disputes. At the national levels, creating social safety nets for those most adversely affected by regional integration (e.g. job losses due to trade liberalization, etc.) could help gain political support for the reforms.

b. Challenges to regional integration

The prevailing institutional landscape is over-crowded with – often overlapping – regional trade arrangements (RTAs). Overall, RTAs have been ineffective in fostering intra-regional trade, as evidenced by its low volumes and over-concentration in a few commodities. To a large extent, these patterns reflect the lack of resource and production complementarities among the RTA members. Existing RTAs need to be streamlined as countries' multiple memberships make the regional integration framework ultimately too costly.

More specifically, the rudimentary stage of manufacturing in most African countries constrains the scope for increased production to supply diverse range of products to the enlarged regional markets. The mere extension of the consumer market will thus be ineffective in boosting intra-regional trade. The underdeveloped infrastructure, particularly in energy and transport, acts as an additional serious bottleneck. It adds to the already high cost of doing business, undermining the competitiveness of African products, both regionally and internationally. Increasing sophistication of the domestic production and strengthening competitiveness are thus key steps for raising intra-regional trade. Finally, regional strategies

³⁴ Africa's integration vision is in the Treaty establishing the African Economic Community (AEC) which came into force in May 1994. The realization that Africa's integration needed a fresh impetus led African governments to reaffirm the importance of integration in the Constitutive Act of the African Union, promulgated in July 2000. The African Union (AU) maintains the thrust of the Abuja Treaty of forging an economically (and perhaps politically) unified continent. The revitalization of Africa's integration through the establishment of the African Union process was bolstered by the New Partnership for African Development (NEPAD), a program of the AU.

have to focus on developing areas of industrial complementarity to raise countries' capacity to trade.

Enhancing factor mobility

Many factors hinder the mobility of production factors in Africa and need to be addressed. The labor market is protected and reserved primarily for nationals, although other complementary qualified and productive workers may be available across the border. The presence of massive foreign workers leads often to tension with nationals, especially in periods of significant unemployment. This, in turn, may create tensions with countries of origin of the migratory labor. The restrictions affecting the access to more vibrant labor markets lead to illegal immigration that further exacerbates frictions between individual countries; these impediments need to be removed. Africa thus needs to revamp immigration policies to ease mobility of skilled workers to help address skill shortages.

The export of capital, including profit, is also still subjected to numerous restrictions. The restricted access for foreigners to some factors (e.g, land) or sectors (e.g., insurance, banking, telecommunications and energy) is another limitation to the free movement of capital into and among African countries. The emergence of sub-regional capital markets may help circumvent such capital flows restrictions, although these markets are yet to prove their capacity to significantly attract such flows. Although many countries (e.g., Sierra Leone) adopted generous investment codes aimed at attracting FDI, the response in terms of increased FDI flows has been weak, underscoring once again the importance of overall enabling investment climate rather than sector-specific incentives.³⁵

Financing of integration

Financing permeates the entire integration process. The major sources of funding of integration institutions and programs in Africa are (i) assessed contributions by member states; (ii) self-financing mechanisms; (iii) limited income generating activities by RECs; (iv) grants from regional and sub-regional financial institutions; and (v) cross-border investment from member countries, including FDI. All these sources of funds have their limitations.

The difficult financial situation is exacerbated by the fact that most development assistance by donors focuses on national development frameworks. Yet, given the challenges that Africa faces and the limitations of the small nation-states, regionalism needs to be mainstreamed in development programs. Loans for regional programs are also hard to obtain for a number of reasons including inadequate capacities to formulate bankable regional projects. The procedures or criteria for granting such loans, especially involving multiple countries, have been opaque and difficult to deal with by African countries in the context of their integration aspirations; they need to be streamlined.

All these factors lead to a relative abundance of integration programs and projects in Africa that cannot be realized because of the lack of funding. The key challenge in this area is then bringing the number of projects in line with available financing. On one hand, this calls for enhancing support from donors for regional programs and projects. Developing loan guarantee schemes for regional programs could be helpful. Still, given the return to fiscal

³⁵ Even when the incentives entice the FDI flows, the development impact of such flows is unclear (Brixiova, Kouakou, and Abderrahim, 2010).

prudence in donor countries after the crisis, alternative financing sources need to be sought. At the same time, the projects need to be streamlined and prioritized to reflect more realistically the available funding.

Mainstreaming regional integration at national level, involving civil society

Regional agreements and projects are rarely incorporated into the national development plans and budgets.³⁶ The weakness of national mechanisms often manifests itself by failure of countries to translate commitments in regional treaties into substantive changes in national policies, legislation, and regulations. Better implementation of regional integration decisions at the national level is thus needed.

As with most major reforms, governments cannot accomplish regional integration without support of their people. So far the integration has been driven mainly by governments. Involvement of civil society in formulation and execution of national policies is key for ensuring that these policies will be implemented. If strategically involved, the civil society can contribute its creative energies and ideas to the community building and consolidation of programs. It can also provide ‘checks and balances’ on governments’ policies and actions. Finally, effective government communication and well-targeted outreach programs to key constituencies could be helpful in gaining popular support for regional integration.

Box II.2.1. Making the Most out of Globalization –Actions

Actions by African countries

Facilitate Global Economic Linkages, on Mutually Beneficial Terms

Capital Flows: (i) Increasing flexibility of macroeconomic frameworks to create room for managing their volatility; (ii) In countries where inflows large, temporary controls on inflows or outflows can be considered, together with a plan for their removal.

FDI:

In general, (i) create competitive environment, remove barriers to trade and investment; (ii) Accompany these measures by building social safety nets for the most vulnerable; (iii) strengthen domestic financial systems; raise human capital and technological capacity.

Specifically, G20 should support: (1) the African catalytic investment portfolio guarantee fund and (ii) the African investment-enabling legal facility.

Trade: Strengthen trade policy (e.g., reducing tariffs and non-tariff barriers); remove supply-side bottlenecks (e.g., building infrastructure); reduce ‘behind the border constraint’ (e.g., improving further business environment).

Move ahead with Regional Integration

- Encouraging Trade: Streamline and reduce the number of RTAs. Create a transparent, equitable, rule-based system for sharing gains and resolving disputes from trade and integration.

³⁶ For instance, in many countries regional integration matters are scattered among several ministries and departments (Finance, Economic Planning, Trade and Industry, Foreign Affairs, Regional Integration) in an uncoordinated manner. Even when a ministry is specifically created to take charge of regional integration issues, it is often not adequately empowered or equipped to ensure effective coordination and oversight.

- Enhancing Factor Mobility: (i) Streamline the cross-border regulation so that foreign workers with the right skills can move efficiently to the countries with relevant job opening; (ii) Phase out restrictions on regional mobility of capital including profit repatriation; (iii) Remove restrictions on access of foreigners to factors of production or profitable sectors.
- Financing of Regional Integration: (i) Rationalize procedures for granting loans for regional integration programs; (ii) Bring the number of regional integration projects down through prioritizing and the realistic assessment of the available sources of financing.
- Involving Civil Society: (i) Incorporate regional projects into the national development plans and budgets; (ii) Involve civil society in design and execution of national policies; (iii) Conduct effective outreach to communicate the national policies and regional programs to key constituencies.

Actions by G20 countries and other development partners

Capital Flows: Improve international regulations to reduce the cyclical bias inherent in the Basel II system.

FDI: (i) Remove trade barriers in advanced/emerging market economies to enhance FDI flows to Africa; (ii) Encourage sending companies to utilize modern and clean technology, share knowledge, and adhere to good standards of corporate behavior.

Trade: Conclude the Doha Round and resolve the outstanding issues in the Economic Partnership Agreement negotiations.

II.3. Human Resource Development

II.3.1. Human Resource Development in Africa

Human resources and economic growth

By enhancing the skills, knowledge and abilities of individuals, human resource development (HRD) serves to improve the productivity of people, which supports economic and social development. Therefore, the development of human resources or human capital is critical component of development strategy.

Africa's challenges in human resource development

Human development is one of the major challenges facing Africa today. Human resource development is a critical factor in the fight to reduce poverty. Poverty reduction in Africa will be achieved only through high and sustained economic growth, which in turn requires significant enhancement in human resources.

Poverty in Africa threatens the most basic component of human resources, namely health. About 200 million people are chronically malnourished and 43 percent of children under five are stunted because of malnutrition. On average nine out of ten malaria deaths globally occur in SSA. Furthermore, more than 20 million people in Africa live with HIV/AIDS.

The deficiency in education hinders the accumulation in human capital in Africa. 38 percent of the adult population in SSA is illiterate and 37 percent of children will not complete primary school. Only 5 percent of the relevant age group is enrolled in tertiary institutions.

II.3.2. Africa's progress in Human Resource Development

Although the lag in HRD is an obstacle to economic growth, the last decade saw a stride in Africa's human resource development. Africa continues to make progress toward the achievement in HRD-related Millennium Development Goals (MDGs), but the progress continues to considerably lag behind most of other regions of the world. The region made substantial progress also in Education for All (EFA) which is monitored by UNESCO. Progress in all the three parts of human resources has been achieved: population health, education attainment, and workforce skills.

Population health

Population health is a precondition for further development in human resources such as education and employment. Substantial progress has been made in Africa in improving the health status of the population. Since 1990 the mortality rate for children under age five (MDG 4) in Sub-Saharan Africa (SSA) countries dropped by 22 per cent – from 184 deaths per 1,000 live births to 144 in 2008.

The risk of death from HIV/AIDS or malarias is declining. The downward trend in HIV prevalence rate and deaths associated with AIDS is due to improvements in access to treatment, changes in behavior, and reduction in infection among the most vulnerable groups. HIV/AIDS-related deaths fell from 2 million in 2001 to 1.4 million in 2007 and new infections declined from 3 million to 2.7 million during the same period. In spite of this progress there is still long way to go; Sub-Saharan Africa which accounts for 72 per cent of all new HIV infection in 2008. Child deaths from malarias declined mainly due to the wider usage of insecticide-treated nets (ITNs). Thanks to increased allocation of financial resources, sixteen SSA countries have at least tripled ITN usage among children under five since 2000. Nonetheless, overall ITN usage still falls short of demand.

Resolving the poverty and hunger is essential for human resource development. In this respect Africa is making steady progress. The proportion of people living on less than \$1.25 a day (MDG 1), dropped by 7 % points from 58 % in 1990 to 51 % in 2005. The percentage of Sub-Saharan African people suffering from hunger is on a steady decline. It decreased to 26 per cent in 2005-07 from 31 per cent of 1990-92. Nevertheless this ratio is still high and progress is slower than in other regions. In addition the lingering effects of the food price hike in 2008 and the reduced income due to the financial crisis could worsen the situation.

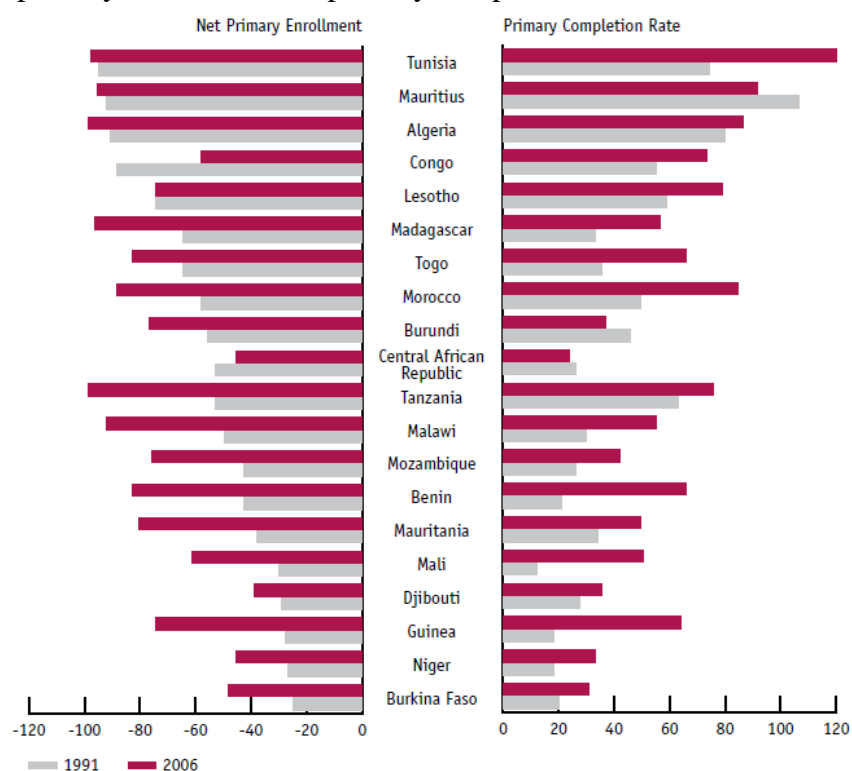
Educational attainment

Africa has made significant achievements in educational attainment (Figure 5). Progress towards universal primary enrolment in particular has been significant in the region since the World Education Forum in Dakar, despite mixed results and slower gains in recent years. SSA has registered remarkable progress since 1999 in reducing its out-of-school population by nearly 13 million, down to 32 million in 2007. Some countries with large out-of-school populations in 1999 had made significant reductions by 2007 (e.g. Ethiopia, Kenya,

Mozambique, Tanzania, and Zambia). Between 1999 and 2007, the average net enrolment ratio (NER) in sub-Saharan Africa increased from 56% to 73%. Still, challenges remain -- an estimated 38 percent of the adult population in SSA, or 153 million adults, lack the basic literacy and numeracy skills needed in everyday life. On a more positive note, the adult literacy rate in SSA has been increasing during 2000s, to reach about 60 percent in 2007.

Improvements in education attainment hinge critically also on a better quality of education. Many countries in SSA – including Burkina Faso, Burundi, the Niger and Senegal– have more than doubled the teacher workforce, in most cases improving the pupil-teacher ratio. According to UNESCO (2010) an additional 1.2 million teachers have to be recruited in sub-Saharan Africa to reach universal primary education by 2015

Figure. 5 Net primary enrollment and primary completion rate for African countries



Source: ECA, AU, and AfDB (2009), p.14.

SSA's progress towards achieving the Education for All has been facilitated in many countries by increases in government spending and international aid for education. Strong economic growth and poverty reduction gains have contributed to progress. Public spending on primary education in sub-Saharan Africa rose by 29% in real terms between 2000 and 2005. International aid is vital for the financing of education in sub-Saharan Africa. The region is the largest recipient of total official development assistance, accounting for about one in every three dollars. Averaged over 2006 and 2007, total annual aid to education to sub-Saharan Africa amounted to US\$3.9 billion, up from US\$2.7 billion a year in 1999 and 2009 (UNESCO, 2010).

Workforce and employment

In SSA, employment rates are higher than in other developing regions. At the same time, working poverty and vulnerable employment are very prevalent in SSA. For instance, the

proportion of employed people living below \$ 1.25 a day was expected to reach 64 percent in 2009, in part due to the economic crisis. The ILO's estimates of the share of vulnerable employment for 2009 range from 75.7 per cent to up to 79.6 per cent, which would take the region back to 2003 levels of working poverty (ILO, 2010).

II.3.3 The role of G20 in Africa's human resource development

The challenge of youth unemployment

In Africa – as in other regions, young people (ages 15 – 24 years) are disproportionately affected by working poverty, unemployment and vulnerable employment. The youth in SSA in mid-2000s made up about 40 percent of the working-age population, but 60 percent of the total unemployed, reflecting that this group is particularly impacted by labor market imperfections. Moreover, the young people are more likely to be in the informal sector than adults, and less likely to be wage employees or self-employed. Specifically, in 2005 in Ethiopia, 81.4 percent and 12.5 percent of youth were in the informal sector and self-employed, respectively, in comparison to 43 percent and 49.6 percent for the adults. The still high fertility rates along with the ongoing demographic in Africa are likely to increase the pressure for job creation over the coming decades.

G20's role in bridging better human resources to more employment

Africa's youth follow two paths in their transitions to working life: many go to work directly with little benefit of formal schooling, while others join the work force after a time in the formal school system. Those who enter the labor market directly without formal training are more likely to end up in low productivity jobs. To help Africa reduce youth unemployment, G20 can cooperate with African countries in the following areas: secondary education, higher education, technical and vocational education and training (TVET), and knowledge sharing for policy capacity.

Increasing access to secondary education

The gap in secondary enrollment rates between SSA and other developing regions widened between 1990 and 2000, though it has been slowly narrowing since then. In the early 2000s, the average enrollment rates for SSA were well below those in other regions (Figure 6). This gap in secondary enrollments has serious consequences for competitiveness and growth. Competitiveness, especially in high value-added and knowledge-based sectors of the economy, depends on knowledge, skills, and competencies associated with abstract reasoning, analysis, language and communication skills, and the application of science and technology. These assets are acquired most efficiently through secondary schooling. The Association for the Development of Education in Africa (ADEA), national governments and bilateral development agencies, and the World Bank recognize the increased enrollment in secondary schooling to be a priority for most of SSA, also to create base for higher education.

Reforming higher education systems

To transform African countries into knowledge-based societies, a comprehensive overhaul of higher education systems is needed in a number of countries. In today's knowledge-based world, no country can reach strong, sustained and shared growth without a capacity to generate, transmit, and utilize new knowledge. Despite this recognition, Africa's stock of

human capital with tertiary-level skills is below that in countries with similar levels of development; this applies especially to sub-Saharan Africa. Moreover, there is substantial mismatch between the demands of modern economies and skills possessed by the recent university graduates in most African countries. While unemployment among the educated is high, shortages of skills, especially in ICT, high-level technical skills and foreign languages persist. To reform Africa's higher education systems though, new sources of financing for higher education need to be identified, including from the private sector. Different forms of state support should also be explored, including credit-guarantees, loan subsidies, and grants.

Africa asks G20 countries to raise the emphasis on higher education in their development agenda in Africa; this is beyond the MDGs. Specifically, donors need to increase aid allocation to higher education in African countries in support of the enrolment capacity and quality of education provided by the African tertiary institutions.

Table 1. Distribution of youth and adults by job status (in percent)

	Employed		Unemployed		Out of the labor force	
	Youth	Adults	Youth	Adults	Youth	Adults
SHIP data						
Burundi, 1998	70.4	95.8	0.3	0.4	29.3	3.8
Côte d'Ivoire, 1998	51.4	81.8	3.0	2.9	45.6	15.3
Cameroon, 2001	42.7	80.9	7.2	4.7	50.1	14.4
Ghana, 1998	17.7	78.4	31.3	8.7	51.0	12.9
Guinea, 1994	69.9	87.8	8.3	5.3	21.8	6.9
Kenya, 1997	20.8	58.2	3.7	1.1	75.5	40.7
Mozambique, 1996	22.0	59.5	2.2	1.4	75.8	39.1
Mauritania, 2000	28.4	50.4	3.1	3.4	68.6	46.2
Malawi, 1997	20.3	58.8	1.3	1.5	78.4	39.7
Nigeria, 1996	23.1	76.7	5.5	1.2	71.4	22.1
Sierra Leone, 2003	40.4	85.4	52.5	10.2	7.1	4.4
São Tomé and Príncipe, 2000	32.8	68.1	4.1	0.8	63.1	31.1
Uganda, 1999	17.9	66.0	0.7	0.6	81.4	33.4
Zambia, 1998	38.7	77.7	6.7	4.2	54.6	18.1
SSA-14 (mean)	35.5	73.3	9.3	3.3	55.3	23.4
SSA-14 (median)	30.6	77.2	3.9	2.2	58.9	20.1
LFS data						
Ethiopia, 2005	72.8	86.5	2.9	1.9	24.3	11.6
Madagascar, 2005	71.7	93.3	1.7	2.6	26.6	4.1
Tanzania, 2005	74.4	93.5	4.9	1.9	20.7	4.6

Source: World Bank Survey-Based Harmonized Indicators Program (SHIP), Ethiopia LFS 2005, Madagascar EPM 2005 and Tanzania ILFS 2005/06.

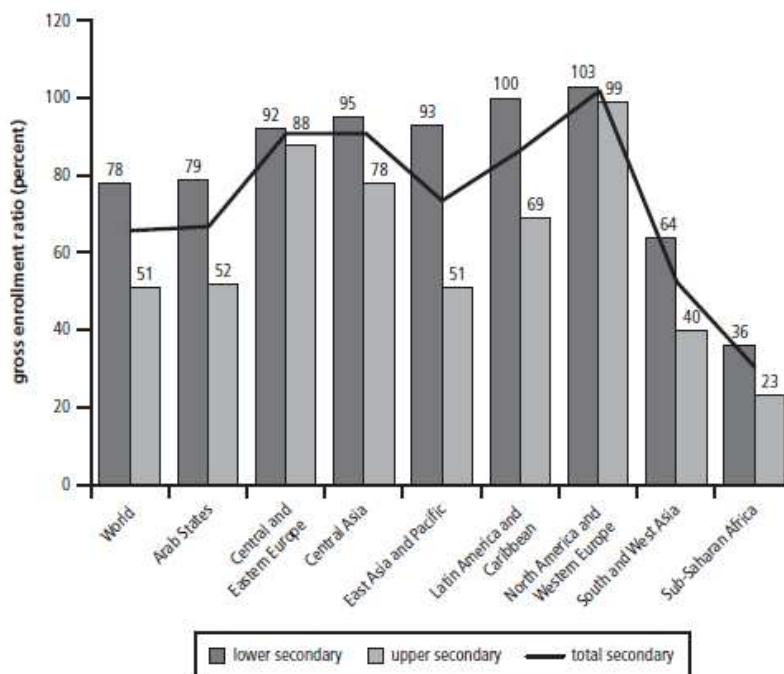
Recited from World Bank (2009), p.5.

More skills for African youth through Technical and Vocational Education and Training

There has been debate about responsibility of government for providing Technical and Vocational Education and Training (TVET) and the trade-off between the achievement of skills development with TVET and the provision of universal basic education. Nevertheless,

skills development for participants in the labor force is important in Sub-Saharan Africa today for several reasons. Technological change and the increased competition require higher skills and productivity among workers. Furthermore, TVET is vital for investment promotion in that the availability of skilled labor is a critical determinant of foreign investment.

Figure 6. Gross Enrollment Ratios in secondary education, by region (2004 or latest)



Source: Verspoor (2008), p.24

A key challenge for African economies over the next decade is to create productive employment opportunities for the 7 to 10 million new entrants to the labor force annually. In a typical African country, as much as 85% of total employment is engaged in the informal economy, with most of this in smallholder agriculture. Growth in the informal sector is probably a permanent feature of African labor markets for the near future. Reaching the informal sector with skills development will be increasingly important for poverty reduction and sustained growth.

State-sponsored training systems play an important role in all countries in Sub-Saharan Africa. The challenge is how to reform these institutions to make them more responsive to markets and more effective in the use of resources. Among the various providers of TVET, state-sponsored training frequently responds to the demand for more costly skills and provides better geographical coverage, but it also suffers from poor quality and a lack of connection with market needs. Budget pressures since the past decade have limited capital improvements and operating expenses, with adverse consequences.

Governments have a public interest in removing skills constraints to economic development and in promoting access to skills for those who are socially and economically disadvantaged. Meeting the evolving market needs will require combined efforts of governments and the private sector in designing, financing, and operating demand-driven TVET institutions.

Better public capacity through knowledge sharing

The performance of public sector in Africa is critical for poverty reduction and sustained economic growth. In many African countries public governance and accountability have improved with the introduction of democracy and the commitment to the rule of the law since the 1990s. Nevertheless, capacity in public sector management remains weaker than in other developing regions. The role of the public sector is essential human resource development as a means for sustained economic growth. The enhancement in public capacity in Africa is especially critical for the establishment of an environment that is conducive to entrepreneurship.

Support from the G20 for capacity building in the public sector would help Africa enhance human resource development and job creation. The knowledge and know-how learned from the development experiences of G20 member countries including Korea who achieved rapid economic growth in part due to active roles of government might provide African countries with valuable lessons and help avoid possible errors in policy-making. Sharing of knowledge and experience of G20 members would be a good vehicle to support public capacity in Africa.

The support for capacity building needs to address three dimensions of public sector capacity: human capacity, organizational capacity, and institutional capacity (World Bank 2005). Workers in the public sector are supposed to have skills to analyze development needs, to design and implement policies, and to deliver services. Public organizations should be bound by a common purpose, with clear objectives and the internal structures, processes, systems, and other resources to achieve them. Lastly, institutional capacity implies the formal ‘rules of game’ and informal norms that provide the framework of goals and incentives within which organizations and people operate.

G20 members could put their knowledge, human resources, and financial resources to support improvement in these three dimensions. Correspondingly, the ownership of African partners is essential for the success of capacity building programs. While external assistance can help by providing inputs to enhance the functioning of the public sector, it cannot directly influence the cultural factors and political economy dimensions underpinning the demand for public sector performance. Therefore, capacity building efforts will succeed only where they take adequate account of the prevailing local political and institutional realities, and are country-owned rather than donor-driven.

Box II.3.1. A case for knowledge sharing: Korea’s KSP

Korea represents economic success among the countries that had experienced colonization and late industrialization. Moreover, Korea is one of the few countries which have become an aid donor country from a recipient country. As the host country of G20 summit in 2010 and a member of DAC, Korea wants to repay the benefits from international society by expanding its commitment to development cooperation.

One of the major features in Korean economic development since the early 1960s was the active role of the government in the rise of industries and private sectors. During the process, the Korean government introduced and implemented successfully many policies such as export promotion, gradual import liberalization, capital and exchange market liberalization, privatization of state-owned enterprises and banks, special economic zone, ICT industry promotion, and so on.

From its development process, the Korean government learned that building policymaking capacity and accumulating knowledge for development in public sector is essential for successful economic development. In addition, the Korean government recognized that the experience and knowledge that it had earned during its development process would be very valuable assets that can be shared with developing countries. Against these backgrounds, the Korean government took it as a pillar of its international development cooperation to share its own development experiences with others.

This development experience is institutionalized as the 'Knowledge Sharing Program (KSP)' which is run by the Ministry of Strategy and Finance. Consultation teams, comprised by former senior government officer, experts from policy institutes and universities, provide policy consulting services to the developing countries. These policy recommendations are based on Korea's developmental experiences, but are customized with considerations of local environments in recipient countries.

The areas of the KSP include economic development strategy, industrialization and export promotion, knowledge based-economy, economic crisis management, human resource development. From 2004 to 2009, Korea shared its knowledge with 15 developing countries in 134 policy topics through KSP. Korea's policy recommendations and its knowledge were capitalized, for instance, in the establishment of Vietnam Development Bank in 2006 and the Navoi Special Economic Zone of Uzbekistan in 2008, and served as a reference for the WTO membership negotiation of Azerbaijan.

The KSP might be considered as a model of 'global knowledge partnership' envisioned by international society. The Korean government will expand the size and area of KSP and operate it jointly with multilateral development banks such as World Bank, AfDB and ADB.

II.4. Structural transformation for strong, sustained, and shared growth

II.4.1. Labor productivity in Africa: gaps and opportunities

Africa's pre-crisis boom and its surprisingly fast and strong recovery have reiterated the continent's immense economic potential. Moreover, the pre-crisis boom was broad-based across countries and wide-spread across sectors, with many (e.g., mining, retail, telecommunications, banking, agriculture) contributing to high growth.³⁷ Moreover, the growth acceleration was not just driven by the commodity boom, but reflected markedly improved pre-crisis macroeconomic policies and structural reforms, such as reforms of the financial sector and labor regulations, and strengthened business environment.

Surely, at only 3 percent of world GDP and trade, Africa's current weight in the global economy is low.³⁸ Moreover, low-productivity agriculture still accounts for most (about 60 percent) of employment in many African LICs, while the surplus labor from agriculture typically works in the informal urban sector.³⁹ A significant and long-standing labor

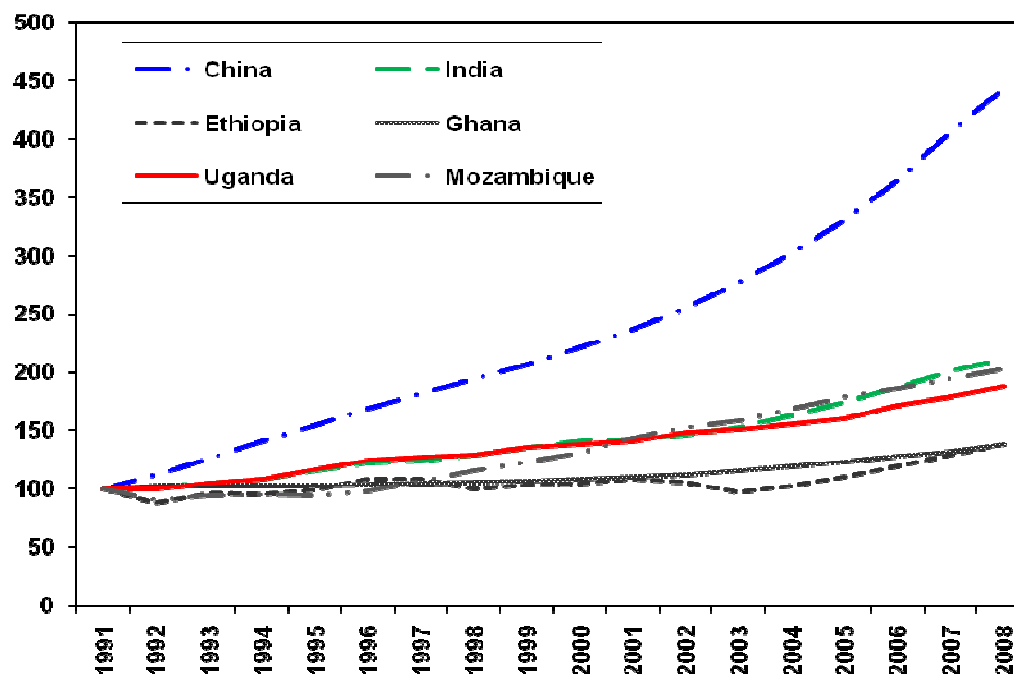
³⁷ The sectoral trends are documented in AfDB and OECD (2010) and McKinsey&Co. (2010).

³⁸ According to the IMF WEO database, in 2008 Africa accounted for only 2.1 percent of world GDP in current prices and for 3.2 percent in PPP terms. Share of sub-Saharan Africa (SSA) was about 2 percent.

³⁹ While the productivity in the urban sector is above the agricultural productivity, it is still often markedly lower than in the formal sector. This leads to the low aggregate productivity.

productivity gap between many of Africa's LICs and other developing countries has thus emerged. On a more positive note, in some frontier markets (e.g., Uganda, Mozambique), labor productivity accelerated in recent years and grew as rapidly as in India (Figure 7).

Figure 7. Labor productivity, Index (1991 = 100), 1991 – 2008 1/



Source: African Development Bank, ILO and authors' calculation. 1/ Labor productivity is measured in terms of number of people employed, not working hours.

Furthermore, the large productivity gaps with advanced economies imply that through the catch up process, African countries could reach real GDP growth rates approaching 10 percent annually.⁴⁰ With such rates African countries possibly could, on average, converge to the per capita income levels of the new EU members around the year 2050 (Klein, 2006). However, for this convergence to happen, structural transformation from subsistence agriculture to industry and high value-added services would need to markedly accelerate. Other factors, such as an enabling external environment and improved educational systems would also need to be in place.

The lack of structural transformation has been the Achilles heel of reform efforts in most African countries so far. While the share of agriculture decreased somewhat over the last two decades (from 18.2 percent of GDP in 1990 to 16.5 percent in 2008), it was due to shifts into mostly low-value added services (e.g. trade) and/or mining, even though in some countries the share of financial services and telecommunications has also increased. The manufacturing sub-sector remained underdeveloped and in fact has steadily declined since the early 1990s; in 2008 it amounted to about 10 percent of GDP compared to more than 30 percent in East Asia (Figure A.9). Several African middle-income countries (Egypt, South Africa, Tunisia) have well-developed manufacturing sectors and buoyant services (McKinsey&Co., 2010).

⁴⁰ One of the underlying assumptions is that the population growth is slightly above 2 percent.

Overall, due to the limited structural transformation and diversification, most countries are heavily dependent on the production and export of traditional primary products and highly vulnerable to external shocks. As many African economies are dominated by natural resource extraction sectors that require very specialized set of skills, diversifying of production and increasing the technological content are challenging. Several exceptions aside (e.g., Egypt, Mauritius, Morocco, South Africa, and Tunisia), the lack of economic diversification and the low technological level have been constraining ability of many African countries to compete globally. They also hampered regional integration. The global financial crisis has reiterated the need for Africa to diversify its economies and find new and sustainable sources of growth.

Despite this overall somewhat bleak aggregate picture on labor productivity trends, several middle-income countries (Algeria, Botswana, Egypt Libya, Mauritius, Morocco, South Africa and Tunisia) give rise to hope. About forty companies located in these countries have been expanding regionally and in some instances globally. In fact, with annual growth of revenues of about 24 percent during 2003 – 08, these companies grew faster than established firms in advanced economies; they were also more profitable (Boston Consulting Group, 2010).

Pockets of dynamism can also already be found in many African frontier markets, pointing to the entrepreneurial spirit throughout the continent. For example, the cut-flower business in Kenya and Uganda has blossomed, while refined leather products from Ethiopia have entered high-end fashion stores in New York. The Nigerian film industry, ‘Nollywood’, one of the largest in the world, has been very active in recent years and became a major source of employment in the country (Klein, 2006). The key question is then how such dynamism can be extended to the rest of the sectors in these countries and elsewhere on the continent.

II.4.2. Advancing structural transformation, raising productivity

In most African LICs, boosting productivity in agriculture is a key challenge and precondition for increased productivity in other activities.⁴¹ While causes of low productivity in agriculture are numerous and country-specific, often they stem from the lack of access to markets, credit and technology. These constraints need to be addressed, together with strengthening institutions (e.g., land ownership), providing training to enhance skills, and removing obstacles to trade. Promoting regional value chains and – more broadly – regional integration will help Africa overcome the additional limitations of small national markets and populations (UNECA and UUC, 2009). Improved infrastructure, human capacities, technology transfer, and increased funding for research could also help raise agricultural productivity.⁴²

For the structural transformation and productivity to take off, constraints to new high-productivity firms in industry and high-value added activities need to be removed. Given the supply-side bottlenecks, a key for reducing production costs continues to be investment in and maintenance of infrastructure. In some countries (e.g., South Africa), the demand inefficiencies caused by energy pricing below full recovery of costs should be removed

⁴¹ Golini, Parente and Rogerson (2002) showed in a calibrated general equilibrium model that agricultural growth is central to development, as its low productivity can substantially delay industrialization.

⁴² Salami, Kamara and Brixiova (2010) discuss constraints to raising productivity of agriculture in East Africa. Ravallion (2008) highlighted lessons in this regard that Africa can draw from China’s experience and found that to reduce poverty, African countries should: (i) raise productivity of agriculture through both market-based incentives and public support; and (ii) create well-functioning state institutions.

(OECD, 2010).⁴³ Africa would benefit from increased competition in product markets; more developed financial markets, and strengthened governance. Reforms before the crisis and few success stories (e.g. Rwanda) notwithstanding, the rigid business environment still reduces Africa's competitiveness (Eifert, Gelb and Ramachandran, 2005; Figure A.10). Labor markets would function better if they were deregulated and social safety nets developed. Moreover, the importance of strengthening institutions and improving governance in Africa cannot be overstated.

Experiences from other developing regions point to the central role played by industrial policy and other sectoral strategies in bringing about faster industrialization and structural transformation to high-value added activities. This is particularly the case in Africa's LDCs, where successful activities and entrepreneurship are often associated with mere survival rather than involvement in highly productive activities (Bonaglia and Fukasaku, 2007). The policies range from incentives for technology development and adoption to pro-growth oriented macroeconomic stance. The new industrial policy should not pick winners, but remove overall obstacles to entrepreneurship in high-potential sectors and industries. At the same time, policymakers should avoid subsidizing energy-intensive and carbon-intensive industries through these initiatives, but facilitate Africa's move to new and green growth path.

For these reforms to yield the intended results (e.g. structural transformation and increased productivity), additional policy space is needed both at the national levels and in multilateral trade and financial agreements. This requires to mobilize increased domestic savings, deepen capital markets and widen access to credit for firms in general and SMEs, farmers, and small investors in particular (AfDB and OECD, 2010). Meanwhile, multilateral and bilateral donors would facilitate this transformation through increasing their financial support to Africa, along the lines of statements at the 2005 Gleneagles summit. By working closely with recipient countries, they would make their financial support more effective through better coordination, increased flexibility and real country ownership of externally funded projects.

Box II.4.1. Structural Transformation for Strong, Sustained and Shared Growth -- Actions

Actions by African countries

Raising productivity in agriculture: (i) Increase access of smallholder farmers to markets, credit and technology; (ii) Strengthen institutions (e.g., land ownership), provide training to enhance skills, and remove obstacles to trade; (iii) Promote regional value chains and regional integration overall; (iv) Improved infrastructure, human capacities, technology transfer, and increased funding for research.

Facilitating structural transformation to high value-added industry and services: (i) Remove regulatory constraints to creation of new high-productivity firms; (ii) Continue to invest in infrastructure and maintain it; (iii) Phase out demand inefficiencies caused by energy pricing below full recovery of costs; (iii) Eliminate the remaining rigidities in the business environment to cut cost of production.

Implementing effective industrial policy: (i) provide incentives for technology development and adoption in high potential industries; (ii) adopt pro-growth oriented macroeconomic stance; (iii) facilitate Africa's move to new growth path, avoid subsidizing energy-intensive and carbon-intensive industries.

⁴³ OECD (2010) discusses these issues in detail.

Create policy space to support structural transformation: Mobilize domestic savings, develop capital markets, and improve access to credit for SMEs and farmers.

Actions by G20 and development partners

Help create policy space to support structural transformation: Increase financial support to Africa, along the lines of (growth-adjusted) statements at the 2005 Gleneagles summit. Improve donor coordination, increase flexibility of project funding and encourage real country ownership of externally funded projects.

II. 5 Infrastructure Deficit: Challenge and Opportunity for Growth

II.5.1 Africa's Infrastructure Deficit: The Facts

For several decades now, researchers, African policymakers, and donors have recognized that the lack of infrastructure networks in basic areas (electricity, transport, ICT and water) hampers growth and sustainable development on the continent.⁴⁴ However, Africa, and especially sub-Saharan Africa (SSA), ranks consistently on the bottom of developing regions in access to infrastructure services (Table 2.a and 2.b). According to the World Bank estimates, Africa's total financing needs in 2008 amounted to \$93 billion a year. Of this, only \$45 billion is currently financed. Even if all reforms aimed at raising efficiency of the infrastructure sector were to succeed and reduce the gap by \$17 billion, a \$ 31 billion a year gap would still remain unaddressed.⁴⁵

The aggregate deficit numbers mask substantial differences across Africa's sub-groups and sub-regions as well sectors. Specifically, the infrastructure deficit is most pronounced in the power sector where many countries suffer from regular power shortages and expansive emergency power, while the ICT gap is much smaller. In fact, several African frontier markets are ahead of major emerging market economies such as India in the usage of mobile phones, demonstrating that in an enabling environment Africa can rapidly adopt modern technology (Figure A.11.a and A.11.b). As far as Africa's sub-regions, infrastructure in East Africa particularly lags behind regional peers (e.g., South Asia) or more advanced sub-regions on the continent (e.g., Southern Africa). The infrastructure deficit of oil exporters relative to oil importers reflects in part that during the last commodity boom the extra oil revenues were mostly spent on consumption rather than investment (e.g., Nigeria).⁴⁶

In addition to the limited overall availability, where the infrastructure services do exist they are very costly in comparison with other developing regions (Table 3). They also tend to be expensive relative to the purchasing power of potential users, which leaves part of the networks unutilized as many of the potential users are simply 'priced out' of the market. Two main factors are behind the high prices of utility tariffs: (i) high cost of production due to the

⁴⁴ Agenor (2010) develops a theoretical model of long-run development based on public infrastructure as the main engine of growth. In his model, a large shift toward spending on infrastructure will generate increase in growth only if governance is adequate, i.e. the degree of efficiency of public investment is sufficiently high.

⁴⁵ Of the annual \$93 billion, about 2/3 are new capital expenditures and 1/3 is on operation and maintenance (Foster and Briceno-Garmenia, 2008).

⁴⁶ In part due to the war heritage, infrastructure gap in fragile states is particularly worrisome.

lack of economies of scale (e.g., power tariffs across Africa) or (ii) high profit margins due to the lack of competition (e.g., road freight tariffs).⁴⁷

Table 2a. SSA's Infrastructure Deficit

	SSA	South Asia	East Asia	SSA Oil Exporters	SSA Oil Importers
<i>Transport</i>					
Density of paved road network 1/	49	149	59	14	57
Density of total road network 1/	152	306	237	70	173
<i>ICT</i>					
Density of fixed phone line 2/	33	39	90	16	38
Density of mobile phone line 2/	101	86	208	118	97
Density of internet connections 2/	2.8	1.7	6.6	1.7	3.1
<i>Energy</i>					
Electrical generating capacity 3/	70	154	231	66	71
Access to electricity 4/	18	44	57	26	16
<i>Water and sanitation</i>					
Water 4/	63	72	75	59	64
Sanitation 4/	35	48	60	34	35

Source: Yepes et al. (2008). 1/ km/1000 km² (2001). 2/ subscribers per 1000 people (2004). 3/ MW per 1 million people (2003). 4/ Percent of households with access (2002-2004).

Table 2.b. Infrastructure Deficit in SSA's LICs and SSA's sub-regions

	SSA's LICs	Other LICs	ECOWAS	EAC	SADC	Central
<i>Transport</i>						
Density of paved road network 1/	31	134	38	8	92	41
Density of total road network 1/	137	211	144	105	214	132
<i>ICT</i>						
Density of fixed phone line 2/	10	78	28	6	74	13
Density of mobile phone line 2/	55	76	72	54	180	74
Density of internet connections 2/	2	3	2.4	2.1	5.5	1.7
<i>Energy</i>						
Electrical generating capacity 3/	37	326	31	24	175	44
Access to electricity 4/	16	41	18	7	21	18
<i>Water and sanitation</i>						
Water 4/	60	72	63	64	71	58
Sanitation 4/	34	51	35	45	43	28

Source: Yepes et al. (2008). 1/ km/1000 km² (2001). 2/ subscribers per 1000 people (2004). 3/ MW per 1 million people (2003). 4/ Percent of households with access (2002-2004).

⁴⁷ The lack of economies of scale reflects the fragmented nature of Africa (with very large number of land-locked countries) and the limited progress with regional economic integration.

In some cases (e.g., internet provision), both factors play a role.⁴⁸ The high costs of infrastructure services markedly reduce the continent's productivity (by half) and competitiveness, while preventing it to reach meaningful gains in poverty reduction.

Table 3. Cost of Infrastructure: SSA and other regions

Tariffs	SSA	Other developing regions
Power (\$ per kilowatt hour)	0.02-0.46	0.05-0.10
Water (\$ per cubic meter)	0.86-6.56	0.03-0.60
Road freight (\$ per ton km)	0.04-0.14	0.01-0.04
Mobile phone (\$ per basket/month)	2.60-21.00	9.9
International phone (\$ per 3 min. to US)	0.44-12.50	2
Internet dial-up (\$ per month)	6.70-148	11

Source: Foster and Briceno-Garmendia (2008).

High prices for services are one of numerous inefficiencies that permeate the infrastructure sectors. Others include: (i) excessive allocation of public resources to ICT (especially in MICs) at the expense of priority areas (energy); (ii) less than full implementation of the fiscal budgets allocated for investment on infrastructure; (iii) insufficient maintenance which creates need for expansive rehabilitation; (iv) inefficiencies and losses during the distribution phase; (v) pricing of infrastructure services below the cost. Timely maintenance in particular could go a long way in reducing the funding needs, since estimates suggest that, for example, \$1 spent on road maintenance saves approximately \$4 in rehabilitation.

The persistently high Africa's infrastructure deficit has imposed major cost on the continent in terms of foregone growth and missed opportunities for poverty reduction. For example, if SSA were to reach the level of infrastructure of Mauritius, its growth of real GDP per capita would increase by 2.3 percentage points a year. Similarly, if North Africa had Mauritius' infrastructure, growth would rise by 1.1 percentage point a year. The extra growth would stem mostly from building additional infrastructure, rather than from improved quality of the existing one (Calderon, 2009).⁴⁹

The key question is then how to generate financing that would reduce the infrastructure gap. Efforts to raise funds need to be accompanied by reforms to address the existing inefficiencies (improved regulation, governance, budgeting, better pricing). Such reform would not only reduce Africa's overall infrastructure financing needs, but also increase returns on investment, thus making the sectors more attractive for private participation.

II.5.2. Traditional and innovative sources of infrastructure financing

In 2008, Africa's infrastructure expenditures amounted to about \$45 billion, of which 2/3 were financed domestically (mostly from budgets, extra-budgetary funds, state-owned enterprises) and 1/3 was financed from external sources (ODA, private investors and emerging market economies). In most African countries, public sector predominates financing

⁴⁸ Foster and Briceno-Garmendia (2008) discuss these factors and other challenges related to Africa's infrastructure.

⁴⁹ Similarly, if SSA had infrastructure of South Korea, it would grow by 2.4 percentage points a year more.

of water, transport and energy, while ICT has already gained substantial interest of private investors.

Given the importance of public funds and central government budgets in financing new infrastructure investments, improvements/increased efficiency in allocation and disbursement of these funds must be a priority. In that regard, African countries may want to strengthen medium-term expenditure frameworks (discussed in Part I) and improve fiscal governance and transparency. These measures need to be supplemented by efforts to improve domestic revenue collection on countries where it is low (e.g., Uganda), while strengthening overall domestic resource mobilization across Africa. On their part, donors need to deliver financing for infrastructure in a timely and predictable manner and put appropriate emphasis on funds for maintenance, not only new investments.

However, as improving domestic resource mobilization is likely to take time and the official aid from traditional donors will clearly not rise (sufficiently) in the near future, African countries need to seek new sources of funds, either from emerging donors or the private sector. Among emerging donors, China has been particularly active in Africa for several years now. Specifically, China's infrastructure finance commitments in sub-Saharan Africa increased from \$ 0.5 billion in 2001 to \$7.1 billion in 2006 and \$4.5 billion in 2007, with many projects backed by natural resources or future revenue flows. For example, Chinese investments in Sudan, Angola and Nigeria were backed by oil, the 2006 investment in Gabon by iron, and the 2007 investment in Ghana by cocoa (Foster et al. 2008).

Regarding increasing private sector participation in infrastructure beyond ICT, *Kenya's issuance of infrastructure bonds* to finance roads serves as an example for other countries with more developed domestic financial markets to follow.⁵⁰ The purpose of issuance was to boost growth as well as develop capital markets and raise their transparency. The first infrastructure bond (US\$232 million), sold in February 2009, had maturity of 12 years and was over-subscribed by 45 percent. The second and third infrastructure bonds, issued later in 2009, were twice over-subscribed. One of the incentives offered, which contributed to the bond's over-subscription, is that holders can use the bond as collateral to acquire bank loans and banks can pledge it as collateral for repos.

As Kenya's experience shows, when long term financing needed for infrastructure is not available from the banking system, infrastructure bonds can be an efficient alternative. They, as well as other local currency bonds, reduce maturity and currency mismatches in banks' balance sheets, thus reducing risk of banking crises.

Ghana's 2007 Eurobond issuance points to the possibility and importance of accessing international markets on good terms, even though in Ghana's case the resources generated by the bond issuance could have been used more effectively. The current plans of *Nigeria to establish oil-financed infrastructure fund* is worth exploring by other Africa's resource rich emerging and frontier markets.⁵¹ The need for the frontier markets to shift 'away from aid

⁵⁰ In 2001, Kenya has embarked on revamp of its domestic bond market. Since then, it has succeeded to lengthening the maturity profile of the debt.

⁵¹ A sovereign wealth fund financed by oil revenue is expected to be set up by October 2010 with about \$1 billion, according to the statement by Finance Minister Aganga in early September.

dependence' was also recognized by IFIs. Correspondingly, pace for non-concessional borrowing was made in the context of the debt sustainability framework.

More generally, a shortage of bankable projects remains a key bottleneck to private investment in the infrastructure sectors, which needs to be addressed. Improving the ways infrastructure financiers and facilities work together could also go a long way in closing Africa's infrastructure gap. Africa asks the G20 to support the African infrastructure development initiative to develop an accelerated pipeline of bankable infrastructure projects with focus on (i) cross-border investments, (ii) water and sanitation, and (iii) renewable energy. The initiative also aims at introducing collaborative ways between infrastructure financiers and facilities. Finally, when taking a broader view of sustainable growth (i.e. one encompassing not only financial but also social and environmental aspects), it becomes important that African countries shift where possible to 'clean energy financing'. Donors and multilateral financial institutions need to support them in this endeavor. The African Development Bank's issuance of its first clean energy bond in early 2010 and the subsequent issuances later in the year are clearly steps in the right direction.⁵²

Box II.5.1 Infrastructure Deficit: Challenge and Opportunity for Growth -- Actions

Strengthen traditional mechanisms of financing infrastructure.

- Specifically, improve and increase efficiency in allocation and disbursement of public funds through government budgets, also through strengthening medium term frameworks (*G20*).
- Improve further fiscal governance and transparency; strengthen resource mobilization, including through better tax revenue collection in countries where it is low (*African countries*).

Continue and enhance innovative ways of infrastructure financing

- Explore options for/viability of issuance of local infrastructural bonds (as in Kenya); sovereign bonds on international markets (as in Ghana), or in case of resource rich emerging and frontier markets -- infrastructure wealth fund as planned in Nigeria (*African countries*).
- Increase share of clean energy financing (*African countries, G20, other partners*).
- Support the African infrastructure development initiative to **increase the number of bankable projects** in Africa (*G20 and other partners*).

In parallel, **address inefficiencies** in building, maintenance and pricing of infrastructure to cut the financing gap. Ease regulations to raise competition in telecommunications, the energy sector, etc (*African countries*).

⁵² These bonds were issued within the Bank's Clean Energy for Development Investment Framework, which is a step towards shifting energy investments to favor low-carbon development paths.

II.6. Green growth development path for Africa

II.6.1. Introduction: Green growth as a strategic priority in the global economy

On 21 June 2010, ahead of the G20 summit in Toronto, the UN Secretary General Ban Ki-moon urged leaders of the biggest 20 developed and developing countries to focus on development, green growth, and the needs of the most vulnerable in designing recovery strategies. According to him, “the best way to enhance the framework for strong, sustainable and balanced economic growth is to put development front and centre, and to invest in a green economic recovery for all.”⁵³ Indeed, in responding to the global financial crisis, the Toronto Summit reiterated their commitment to a green recovery and sustainable global growth.⁵⁴

In the process of global economic recovery, green growth is considered a strategic priority by the G20, as well as major global institutions along with the traditional concept of growth based on GDP, while it encompasses a wide range of objectives that are critical to long term global economic development. To be specific, the objective of green growth is for reviving the global economy, boosting employment, expediting the fight against climate change, therefore, ultimately to achieve a sustainable growth in the world economy. In that sense, green growth is relevant beyond relieving the impact of the current economic crisis.

The G20 has 66 percent of the world’s population, producing almost 90 percent of global GDP. They are also responsible for 80 percent of global greenhouse gas emissions, as well as commanding much of the world’s annual USD 150-250 billion fossil fuel subsidies⁵⁵. Therefore, they are required to ensure that their investments set out to stimulate stagnant economies contribute to mitigating climate change, as well as reaching the impending millennium development goals (MDGs) especially eradicating the poverty. In this context that, for the G20 meeting in Pittsburgh, the UNEP called on the 20 largest economies to engage in a Global Green New Deal by investing at least 1 percent of their total GDP in promoting green economic sectors.⁵⁶ UNEP suggested that the G20 countries use a significant proportion of their investments focusing on improving energy efficiency in buildings, supporting renewable energy technologies, sustainable transport technologies, ecological infrastructure, and sustainable agriculture. Although there is a large gap to fill among countries, progress has been made as many governments put in the effort to adopt expansionary stimulus packages, including green growth-oriented policies.⁵⁷

⁵³ Referring to UN News Service “Ban urges focus on development and green growth ahead of G20 summit” on 21 June 2010 <http://www.un.org/apps/news>

⁵⁴ The G20 Toronto Summit Declaration, para. 41, 26-27 June 2010

⁵⁵ Global Green New Deal- An Update for the G20 Pittsburgh Summit p.1, UNEP, September 2009.

⁵⁶ Global Green New Deal- An Update for the G20 Pittsburgh Summit p.1, UNEP, September 2009.

⁵⁷ According to a report from UNEP report on a Global Green New Deal, almost 15 percent of the global stimulus packages to date can be considered green in nature, and these commitments are largely concentrated in a few leading members of the G20. Yet another report from HSBC Global Research by Robins et al. in 2009 and 2010 about green stimulus, of the USD 3.3 trillion allocated worldwide to fiscal stimulus over 2008-9, USD 522 billion was devoted to such green expenditures or tax breaks, and it seems that not only developed countries but some emerging economies like China (spending USD 218 billion from September 2008 through December 2009, which accounts to a third of its total fiscal spending) contributed to a significant extent.

In consideration of the significance of green growth, the coming G20 Summit in Seoul will take the issue as a new approach for the development agenda, on which the host country would like to focus along with the global financial safety net. As the premier forum for international economic cooperation, the G20 Summit deals with environmentally and socially sustainable economic growth and “green growth” is undoubtedly the central to the agenda.

II.6.2. Clean development mechanism viable for Africa

When it comes to green growth, the question of its viability or feasibility in applying green development strategies to developing or under-developed countries is raised, as it seems to require cutting edge technologies and a huge amount of investments. However, that question does not penetrate through the fundamental attribute of the issue. As it should be focusing on how to accomplish the way to have a green economy, rather than on whether it is viable for certain groups of countries. Many issues related to the development agenda, such as climate change, food and energy security, job creation, and poverty eradication, demand intensified international cooperation. Therefore, industrialized countries, as well as developing countries and lower income countries including many states on the African continent, should also be concerned about adopting clean development mechanism. While many African countries are among the most vulnerable to the impacts of the recent economic crisis and climate changes, it is critical to devise a clean development mechanism in the region.

The recent global recession served as a wake-up call for the world leaders, including those in Africa. It caused a drastic drop in global demand and trade, which in turn affected on global output. Facing the negative impact of the crisis in financial and commodity markets, the global economy is keen to find a new source or a new mechanism for sustainable growth. In this context, green growth has emerged as a central focus of to the daunting task of economic recovery and the MDGs achievement. It is about pursuing economic development, while reducing pollution and greenhouse gas emission, enhancing the efficient use of natural resources and maintaining biodiversity. That is, environment oriented investments are needed.

Along with overcoming the current economic recession, Africa is given the daunting task of maintaining stability in the economy, accomplishing sustainable economic growth and employment, and addressing food security and climate change. For dealing with the task, more investment is needed in Africa’s real economy. Infrastructure, transportation, energy, agriculture and communications are the sectors that especially need such intensified investments. By inducing more investments in these sectors, the continent could sustain the momentum for further growth, as well as addressing other economy-related issues. The investments with green growth initiatives in Africa have critical meaning to the world economy, as it could broaden its markets by the results of the continent’s growth. From both perspectives of Africa and its international partners, green growth initiatives should lie in the centre of their concerns.

In fact, Africa has shown resilience in confronting the current crisis maintaining 2.5 percent growth rate in 2009, while those of their international partners have been contracted. As for the sub-Saharan region, its real GDP growth rate in 2010 is projected to be 4.1 percent.⁵⁸ Based on the data, the continent can be considered to be rich in potential as a new growth pole in the global economic system..The G20 has made its commitment for an environmentally and

⁵⁸ See “Regional economic outlook, Sub-Saharan Africa: weathering the storm”, Table SA1: real GDP growth, Oct. 2009.

socially sustainable economic growth and actively engaged in a green growth deal.⁵⁹ For this purpose, African countries need to set a specific low carbon growth path in relation to the development agenda to induce more financing resources.

Given the gravity of the issue in the long run, the coming G20 Summit in Seoul would take the development issue as a major element of the agenda. The development agenda itself is not a new subject to the international institutions or forums, even to the G20 Summits. For the Pittsburgh meeting, the leaders of the G20 were already called for contributing to sustainable economic growth by engaging in a global green new deal, which requests them to invest at least 1 percent of their total GDP in promoting green economic sectors. In the Summit in Seoul, the Korean government will suggest more of a specific approach towards the development agenda as to giving a new momentum to developing countries with a growth-oriented strategy. And that would definitely be in compliance with the notion of green growth. As a G20 member country, Korea has been working on advancing the progress towards sustainable low carbon economy by adopting the Green Growth Strategy. The country is making enormous effort to transition into a green economy, which is a new paradigm to create jobs, as well as to have a new growth momentum. Of the total green spending in the Asia Pacific region that amounts to USD 342 billion, Korea has devoted a substantial amount while it allocated nearly 80% of its total expenditure to green investments.⁶⁰ Along with that, showing the government-wide effort towards green growth, the Presidential Committee on Green Growth was established in February 2009⁶¹ for implementing green growth strategies over the 5 year period from 2009 to 2013. The kind of effort that the Korean government has made is notable, as it could represent what benefits green growth strategies can bring about, while major economies that caused or were hit hard by the global crisis fall short of their commitment in relative terms.

Korea has already shared its green growth vision with Africa in the second round of the Korea-Africa Forum as they adopted Korea-Africa Green Growth Initiative—an annex to the Seoul Declaration—, promising to achieve sustainable growth in a coordinated and harmonized manner. To be more specific, Korea and Africa “agreed to expand bilateral and multilateral channels for dialogue between Korea and Africa to build a consensus on green growth and hold policy forums to strengthen partnership for low-carbon green growth.”⁶² By the accord, the two agreed to implement environmental cooperative projects, such as water supply, waste treatment, and other management natural resources. Furthermore, being fully aware of the need to transition into a new paradigm, which is expected to bring in more benefits by tackling the global environmental issue and the creation of green markets, both parties agreed on mutual cooperation for exploring clean development mechanism including transfer of green technologies.

To sum up the aforementioned facts, it is safe to say that a foundation for international cooperation in preparing a green growth path has been established, and developing countries including many in the African continent have shared the need for it. And as the host country

⁵⁹ Global Green New Deal- An Update for the G20 Pittsburgh Summit p.1, UNEP, September 2009

⁶⁰ See Edward B. Babier, “Toward a Global Green Recovery: The G20 and the Asia-Pacific Region,” *The Asia-Pacific Journal*, 28-2-10, 12 July, 2010.

⁶¹ See <http://www.greengrowth.go.kr> for more information about the Korean government’s taking initiatives for green growth.

⁶² Referring to “Korea, Africa Share “green growth” vision” by Kim Sue-young, 24 Nov. 2009 http://www.koreatimes.co.kr/www/news/nation/2009/12/113_56038.html

for the coming Summit, Korea is keen on taking it as the key agenda in relation to development for the post-crisis era.

II.6.3. Policy recommendations

To realize its abundant potential to become another major growth pole in the global economy addressing other issues like climate change and poverty eradication, Africa should show the world their willingness to do so.

Domestic leadership matters: policy choices for the future

To cope with the impact of the crisis and to seize the opportunities to develop, African countries can learn from the Korean economic development history, in its early stage of development where it was demonstrated that the willingness of the government to drive the direction of domestic industries plays a big role. With weak economic fundamentals, the role of the government to ensure a stable environment for investments cannot be emphasized enough. Therefore, to induce more investment to boost green growth strategies in Africa, governments of the continent need to pursue domestic reform, in order to create a conducive environment for cooperation with other actors, as well as specific schemes for development.

African countries huge reserves for energy resources and growth potential continue to attract investors in the developed Western partners as well as emerging Asian economies. Compared to the Korean case, the starting point for devising and implementing development initiatives is strong, so much so that if the domestic leaders take the right strategies in forging an enabling macroeconomic environment for green growth path, it would help not only to protect the continent's natural resources, but also to contribute to the world economy's progress in the transition to new paradigm of sustainable growth.

Devising a clean development strategy: preparing specific development mechanism

Given its abundant natural and biological resources, good opportunities exist to set a low carbon growth and development path. With a coherent investment scheme in line with clean development, the continent could attract financial and technological support of investors including rich countries, and multilateral or regional institutions.

For example, investing in Africa's renewable energy sources, such as solar, hydro, wind, thermal and biomass would be a good project to draw international financing, as it could contribute not only to addressing global climate changes and local energy shortage problems, but also to providing a chance to create a new global market.⁶³ This kind of investment can bring about more jobs and trade chances in Africa.

A relevant example to the African context would be South Africa's Green Economy Summit in May 2010, calling for the development of green growth policies and regulations which

⁶³ For the need of green growth strategy in Africa, refer to Michael Keating, "Green Growth strategy viable for African economy", The Great Debate UK, Reuters, 12 June 2009, <http://blogs.reuters.com/great-debate-uk/2009/06/12/green-growth-strategy-viable-for-african-economy>.

support the development of clean technologies.⁶⁴ The country anticipates gains in terms of job creation by boosting the renewable energy sector. These positive experiences should be emulated in other countries.

Cooperation with multilateral and regional institutions

■ Cooperation with international institutions

Whilst the work of developing a “green growth strategy” requires a broad and flexible mix of instruments in several policy areas, including taxation, technology, human resource and natural resource management and other infrastructure establishment, it is necessary to devise those schemes in close cooperation with the international partners. Even though the level of socio-economic development of African countries varies and many are largely dependent on official development aid from abroad, they should take part in the coordinated effort of the international society by promoting their clean development strategies.

When the world is keen on finding a new growth paradigm, many international organizations and multinational banks are pursuing projects in line with the trend. The OECD member countries consisting of major donors to the continent has recognized the importance of green growth, pledging their continuous effort on innovation and reforms, for tackling climate change and setting the framework for green growth.⁶⁵ Extending this initiative, the Pittsburgh G20 Summit was requested to build on the joint work of EPOC and the Economic Policy Committee on the economic and environmental benefits of removing fossil fuel subsidies.⁶⁶ As an OECD member country and the host country of the coming G20 Summit, Korea takes the agenda of green growth as the basic principle for achieving a sustainable recovery and a growth momentum, calling for more direct implementation of the existing commitment.

Africa, as the continent on the centre of concerns for the international bodies in terms of global economic issues, cannot afford to stay behind in this multilateral effort for clean development given its growing interdependence with the world economy. Undoubtedly, some takes a skeptical look on this notion for Africa, saying that it has little contributed to the world’s climate change but is unfairly compelled to share the responsibility as international community demands a new development scheme with higher costs. One of the reasons for skeptical opinions towards Africa’s green growth initiatives is because implementation or application of green technologies is not viable for under-developed countries due to the higher the costs of adopting new technology.

However, this problem can be solved though for knowledge sharing with multilateral institutions, regional bodies as well as individual investors. By enhancing the cooperation

⁶⁴ For further summarized information about the summit, see “summit calls for government to fast-track green growth”, South Africa The Good News, 21 May 2010 www.sagoodnews.co.za/economy/summit_calls_for_govt_to_fast-track_green_growth.html.

⁶⁵ To see more specific contents of commitment in relation to the coming G20 summit in Seoul, refer to the remarks by Angel Gurría, OECD Secretary-General, “The Korean G20 leadership: Assessing the key issues for 2010- New sources of sustainable and balanced growth” 17 Nov. 2009, www.oecd.org/document/18/0,3343,en_33873108_33873555_44080146_1_1_1_1,00.html.

⁶⁶ Quoted from the remarks by Angel Gurría, OECD Secretary-General, at the Environment Policy Committee meeting (EPOC) under the subject of “Towards green growth: how can the Environment Policy Committee contribute?”, 21 Oct. 2009.

with these international organizations, African countries could tap more financial resources to invest and benefit from the transfer of green technology in support of sustainable economic growth.

■ Inclusion of the private sector

Given that green growth encompasses a wide range of innovations, public resources alone cannot fully cover the costs associated with climate change and set clean development schemes customized for each country in Africa. Therefore, international economic organizations and forums should discuss ways to incentivize private capital to participate in those clean development schemes in the region. In the process of development, the ultimate goal of relevant schemes should be independent market-oriented industrial development.

Providing another African perspective, the AfDB has been working on diverse pilot programs to expand the sources of investments, such as renewable energy sector or infrastructure to utilize the given natural resources in the continent. By expanding investment opportunities, Africa could induce more finance to fill the gap between its demand for investments and public resources in hands. The G20 countries and other multilateral economic institutions should redefine their role, growing out of their traditional role as aid donors to partners in preparation for the coming era.

II.6.4. Concluding remarks

The world economy has been facing a critical phase transitioning towards a new development paradigm. As the green growth strategy is considered to be a must process for recovering from the current economic deadlock, it is put on the centre of the negotiation table set by the G20. Given its framework, the G20 Summit will not give hard-binding strategies for green growth in terms of development.

Africa has been showing stable economic growth for the last decade and proved its potential to be a new growth pole in the post crisis global economy. With its growing interdependence with the global economy, the continent is required to participate in the international efforts for achieving sustainable economic growth by embracing green growth development mechanism. By doing so, many African countries could draw more investments from international public funds and private sector, providing a new source of growth. Thus, African countries have to ensure determined leadership to choose the right policies to achieve stable political and macroeconomic conditions and to align national interests with the global economic objectives of clean sustainable growth. Furthermore, they should actively utilize projects boosting green industries, such as clean energy or green agriculture, initiated by multilateral or regional institutions. Cooperation with those institutions in support of the clean development mechanism will yield economic benefits with minimal environmental costs.

II.7. Global Governance and Africa's Voice in the International Financial Architecture

II.7.1 Current Position

Although Africa currently has only limited linkages to the global financial system, the financial and economic crisis, and the preceding food price crisis – none of them of Africa's own making -- demonstrated clearly that the continent is highly impacted by global volatility. Its growth prospects were diminished, there was a reduction in investment, credit and in particular trade credit dried up. Much the same applies to climate change: Africa has

contributed the least to past emissions (and contributes less than 4 percent to global warming now), yet the continent is projected to be hit hardest by climate change. It is already feeling its effects, and bearing the costs.

It has been said repeatedly that global crises require global solutions, taking fair account of the interests of all parties. Many African countries depend on access to concessional resources or loans from the IFIs, but have limited voice in governance of these institutions. The current international financial and economic architecture remains dominated by the major economies. When approached by developing and emerging countries, the response from capital and financial markets are also guided mostly by the stance taken by the IFIs.

The G7 and traditional donors are the major shareholders in the IMF, and the World Bank, and substantial shareholders in the Regional Development Banks. They dominate strategy and policy development, priority setting, and resource allocation, particularly for low income countries. Until recently, a broadly shared view, the so-called 'Washington Consensus', guided the approach of both multilateral and bilateral development institutions. It had a significant impact on many African countries through decisions on for example policy conditionality; debt sustainability and fiscal space; eligibility and conditions for debt relief; credit policies; performance based allocation systems. Harmonization and coordination of policy in practice meant as much the presentation of a common position by donors, rather than conformity with the strategic policy framework and choices of the recipient. Poverty reduction strategies, designed to ensure country ownership behind IMF and World Bank lending, played in reality marginal role. However, the recent global financial crisis exposed the weaknesses of the Washington consensus and for African policy makers also reinforced search for new development paradigm.

The G20 is now emerging as the leading forum for international economic and financial governance. However its remit, the scope of its work, and its relationship to other international organizations is still evolving. G20 Members recognize that its legitimacy and credibility will depend also on its composition. Choices have to be made between inclusion and efficiency. It is acknowledged that Europe is over-represented (unless economic size is the sole criterion) and that Africa is under represented. G20 is seeking to reach out to non-members.

Consensus seems to have emerged that G20 Leaders meetings should retain a broad focus on economic and financial matters. It is uncertain how they will deal with issues such as development, energy, trade and climate change, and the extent to which there should be more overtly political issues discussed, such as peace and security – as is the case in the G8. There are discussions about setting up a permanent Secretariat, but for the moment the host nation retains a central role, usually in consultation with the host of the next meeting. With the initiative of Korea to put development forefront in the coming Seoul Summit it is likely that over time the G20 process will supplant the development agenda of the G8. The host country decides on invitations to non-G20 members.

Representatives of G20 Heads (Sherpas) will meet regularly, but much of the policy preparation for the Summits will fall to Finance Ministers. The G20 Finance group has a relatively well defined composition and mandate, Finance Deputies meet frequently and this places a premium of continuity of participation, expertise and experience in the issues being discussed. The World Bank and IMF are observers in the G20 but can play a substantive role at the finance level. The African Union was represented in London and Pittsburgh as an

observer, at the invitation of the host governments. As a result of this observer status, Africa has not been able to fully participate at the meetings of the Sherpas and Finance Ministers.

The crisis has added weight to the Basel Committee on Banking Supervision and the Financial Stability Board on which Africa has also scant representation. Although not systemically important in the financial system so far, African countries are directly affected by the decisions taken in these bodies, which are not always in the best interests of their financial sectors.

Basel II will become the framework for banking supervision and regulation globally. Potential implications for Africa are that the new arrangements might adversely affect the cost of financing, and inhibit cross border financial flows to countries where public and private borrowers are rated at a higher level of risk. By remodeling risk-weighted assets, Basel II is likely to influence also how credit will be allocated within countries, to the real economy.

II.7.2 Assessment

Other sections of this paper have shown the need for more innovative approaches; that “one size fits all” prescriptions are inadequate. Business as usual is not acceptable. The G20 have agreed that as part of their own mutual assessment they will consider the impact of their policy actions on LICs. This is welcome, but room must be created for input from the LICs themselves.

A cardinal lesson from successful development elsewhere, in particular Asia, is the importance of country ownership and commitment, of policy and strategies being determined by country circumstances, the country’s own priorities. For instance, the balance between the market and the state will differ from country to country and from time to time. More policy space has to be given to LIC and emerging economies. This has to be reflected in the key policy and standard setting organizations, and when decisions are made on the allocation and use of resources. Africa therefore needs to be adequately represented, to have its voice heard, in the key policy and decision making international structures, not just being informally consulted.

Africa’s patterns of trade and investment have altered significantly over the past decade. China, India and other emerging market (e.g., GCCs) countries have become major trading partners, have invested in Africa, and have become donors of development assistance. Much of this has been bilateral rather than channeled through multilateral organizations.

Other sources of finance, particularly remittances and FDI flows, have become an important source of funds for many African countries, more important than aid. These are directly affected by economic circumstances and the policies in G20 countries. At the same time, using these flows productively, providing the secure and enabling environment for domestic and foreign investors while attracting development-friendly FDI, is critical for Africa’s growth prospects.

II.7.3 Recommendations

Mobilizing domestic resources, making the most effective use, maximizing the value of the development resources is fundamental for Africa to reach its economic potential and become a global pole of growth. African countries must provide the policy frameworks, the sound policies, effective institutions and accountable governance on which this will depend.

Accountability of African Leaders is to their own citizens above all. Both they and the donors of development assistance are right to expect results. Equally Africa must be able to engage fully in key international governance bodies; it cannot continue simply to be the recipient of decisions made elsewhere.

Of course all 53 African countries cannot all be represented individually in every organization. Nor is it realistic to expect one country alone, such as South Africa in the G20, to set aside completely its own national concerns in order to represent all other countries. There has therefore to be more scope for continental and regional representation, scope for African-led institutions to be able to engage on equal terms in global discussions, to put forward African perspectives and to draw attention to the implications for African countries.

Africa should have permanent representation at the G20 to ensure participation at all levels of preparation towards the Summits. The African Union of course remains the primary political voice for Africa as such and should participate in G20 meetings. Within the continent Africa has a number of overlapping regional organizations and economic communities; efforts to rationalize and streamline the structures and reduce duplication should continue. Investing in African development institutions, where African countries have a majority shareholding such as the African Development Bank, should be a policy priority for G20 countries.

Africa should be adequately represented on the Financial Stability Board, possibly through the Association of African Central Banks, which is aimed at coordinating and monitoring progress in the strengthening of financial regulation.

In addition, Africa should have a say in G20 recommendations on the reform of the international financial architecture.

II.7.4 Next Steps

Existing commitments to increase African shareholding in the IMF and World Bank Boards, and to governance reforms in the IFIs, should be implemented swiftly.

African countries themselves must improve their collective discussion on key financial and economic issues so that African representatives can play a full part in international discussions. The Committee of Ten African Finance Ministers and Central Bank Governors (the C10) should continue to meet regularly, provide advice to African Heads and to the G20.

The Paris and Accra Accords on harmonization should be given full effect and African countries should take the lead in proposing improvements in current practice.

South – South cooperation and lesson learning have a good deal to contribute; Korea should encourage the emerging country G20 members to be more pro-active and develop comprehensive programs of cooperation with Africa as a continent.

More space should be given for African countries to make their own policy choices and to be accountable for the results. As a first step the current CPIA methodology and its application in Africa should be reviewed jointly by African countries, IDA/ADF Deputies, WB and AfDB staff and early recommendations made to respective Boards.

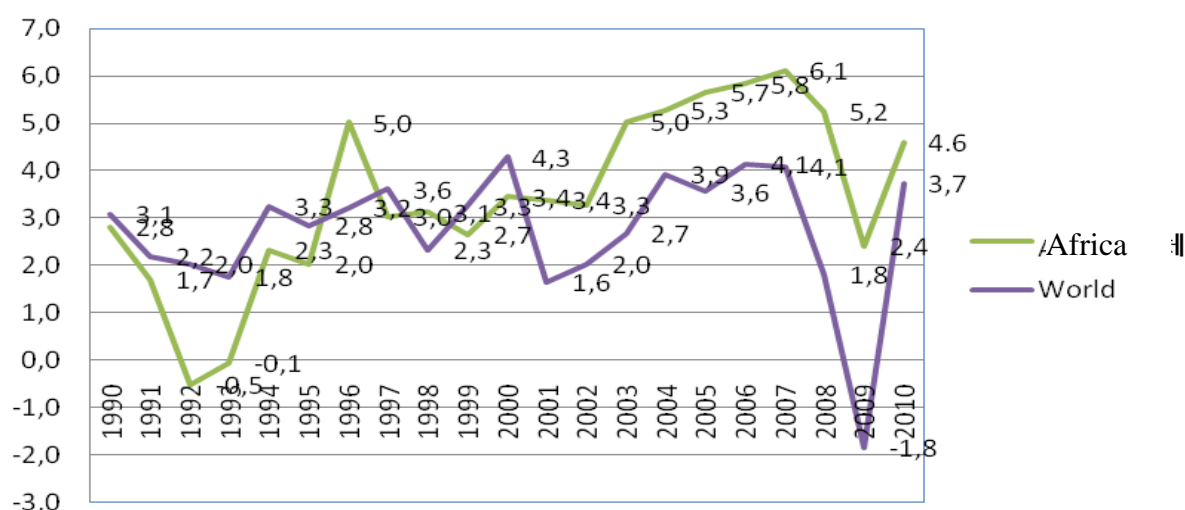
PART III. AFRICA AS A NEW SOURCE OF GLOBAL ECONOMIC GROWTH

III. 1. New Trend in Africa's Economic Growth

Africa has changed. It has become one of the world's fastest growing economic regions, from a country which has been historically renowned as a slow growth region. Africa's annual economic growth rate has increased to average 5.6 percent in the period of 2001-2008 from 2.3 percent in the 1990s. It has exceeded the global average growth rate more than twice in the 2000s. Among all African countries, more than 1/3 (about 40 percent) countries recorded an average growth rate of over 5 percent between 2001 and 2008.

This high growth trend seems to have gained a stable basis. Figure 8 shows the stable trend of economic growth in Africa in the 2000s until 2008. Even during the financial crisis, African countries recorded 2.5% of growth rate in 2009, while the world economy shrank significantly. The IMF estimated that African countries would grow by 4.6% in 2010 also. Despite anemic global economic downturn, Africa is maintaining a robust growth rate with its 2010 estimate twice as high as that of 2009. African economies revealed their stable growth capacity, as well as resilience.⁶⁷

Figure 8. Annual Growth Rate (percent)



Source: Global Insight.

What would explain this new trend of economic growth in Africa? Africa's economic upturn was caused by political and macroeconomic stability and microeconomic reforms. Even though natural resources accounted for 24% of the whole growth, all the economic sectors contributed to the overall economic growth including resources, finance, retail, agriculture, transportation and telecommunication. This new trend indicates that there is a fundamental change occurring in Africa. McKinsey Global Institute (2010) argues that the key to Africa's growth surge was government reforms that created greater political stability, improved macroeconomic stability and invigorated business sectors.⁶⁸ Among others, Gueller (2009)

⁶⁷.Additional information on growth trends is in graphs A.12-A.16.

⁶⁸ McKinsey Global Institute (2010), 「Lions on the move: The progress and potential of African economies」 . June 2010.

emphasizes Africa's economic environment improved by better macroeconomic management, better fiscal and balance of payment positions, and lower external debt levels.⁶⁹ Political stability across the continent has improved as well. The economic reform index announced by the International Finance Corporation (IFC), the private sector arm of the World Bank, supports such movement. The African continent which used to be ranked at a lower level in the past was placed third, following East Europe and OECD countries, showing prudent economic reforms leading to the creation of a positive business climate in the region. The economic environment in Africa became more productive, due to all of these aforementioned fundamental changes.

Africa's new growth trend provides a new vision to the future of the continent and the global economy. Africa used to be a continent that needs international aid due to persistent war and poverty. The continent which has been dependent on aid is now showing promising economic growth with its own effort toward overcoming poverty and developing domestic industries. Africa now attracts attention from the world not only as an aid destination, but also an investment destination. Fast growing African economies signal the second generation of emerging markets in this continent.⁷⁰ The world expects a new market and a new source of demand, which would contribute to the rebalancing of global economy.

III.2. Possible Directions for Economic Growth in Africa

Long-Term Growth Potential

The McKinsey Global Institute (2010) draws rosy long-term prospects on the basis of growth potential in Africa.⁷¹ First, natural resources will continue to increase wealth in this continent from a rising global demand. The continent is endowed with 10 percent of the world's oil reserves, 8% of gas reserves, 40% of gold reserves and a wealth of other precious metals. Fast growing demand for raw materials will induce foreign direct investment not only to explore the resources, but also to develop infrastructure, which would have positive spillover effects to the neighboring region. The second growth potential is the sheer size of arable land. The size of Africa's land is much greater than that of China, USA, Europe or any other region. With the increasing number of population, land will constitute an attractive investment destination. The third asset is Africa's labor force, which is expected to reach 1.1 billion by 2040. The large workforce will form a basis of global consumption, as well as production.

The aforementioned factors will induce a long-term economic development. The critical question now is, however, whether this region would be able to continue the high economic growth and take advantage of the favorable natural conditions. Due to the wide variations across African economies, it is not appropriate to adopt one growth strategy for all the regions. African regions are classified often into three or four groups; the oil-exporting countries, resource poor but diversified economies, and slow-growth economies. The Slow-growth group includes coastal and land-locked economies because the access to international trade

⁶⁹ Güller (2009), "Africa Rising: The Next Generation of Emerging Markets?" p.2.

⁷⁰ Nellor (2009) identifies eight sub-Saharan African countries as new emerging markets: Botswana, Ghana, Mozambique, Nigeria, Tanzania, Uganda, and Zambia.

⁷¹ See the details in McKinsey Global Institute (2010), p.14-24.

determines economic growth.⁷² Given this wide variation, African countries may apply the flying-geese model or the growth-pole strategy to find possible directions of development.

The Flying-Geese Model

The flying-geese model, a theory of industrial development in latecomer economies, can be used to explore the prospects of African economies. Industrial development follows a pattern where countries transit from the production of lower to higher technology goods. The industrial structure of a country advances from consumption goods to capital goods industry through diversification and differentiation from other industries. In order for countries to move from textiles and simple assembly to more complex products, they need to move up the learning curve, notably through investment and technology transfer from advanced economies.

Economic development in East Asia in the 1980's illustrates this process. Japanese firms sparked an industrial boom in East Asia, where newly industrializing countries of the region played a central role in the rapid expansion of manufacturing in Asia. As such, one country can lead other economies toward industrialization, passing older technologies down to the followers as its own incomes rise and it moves into newer technologies. In Asia, Japan was the leader of this flying-geese model.

Because there is such great variety in the African economies' stages of development, natural resource endowments, and historical heritage, the flying-geese model can be applied to broaden the basis of economic growth. It is precisely this diversity that works to facilitate the flying-geese pattern of shared development, as each country is able to take advantage of its distinctiveness to develop with a supportive division of labor.⁷³ Africa's most advanced economies such as Egypt, Morocco, South Africa, and Tunisia have already established significant manufacturing and service sectors. The manufacturing sector of these countries already stands under competition pressure, due to the relatively higher unit labor costs than those in China or India. South Africa and Morocco started to move toward producing higher value goods by investing in automotive industries. If they shift the industries with lower value to neighboring countries which are ready to adopt them, the flying-geese model will begin to materialize in Africa.

The Growth Pole Strategy

Growth does not appear everywhere at the same time, but rather begins at a certain selected point, which receives concentrated resource inputs for fast growth. According to the growth pole theory by Francois Perroux, growth is assumed to originate in a region where a propulsive industry is located, which then spreads to surrounding regions. The concept was broadly used in developmental plans for developing countries in the 1970s, such as The National Land Development Plan in South Korea.⁷⁴

The growth pole theory can have a significant implication for development in Sub-Saharan

⁷² Among others, See World Bank (2007), 「Africa Development Indicators 2007」.

⁷³ Refer on flying geese model to Kojima, Kiyoshi (2000): The 'flying geese' model of Asian economic development: origin, theoretical extensions, and regional policy implications. In *Journal of Asian Economics* 11, pp.375-401.

⁷⁴ In the U.S. the concept of growth poles has usually taken the form emphasizing geographic location which are called "growth center" related to the concept of agglomeration. England, too, has applied growth pole theory to regional policy since the 1960s.

Africa; the whole continent can enjoy positive spill-over effects of selected growth poles. The region's recent performance offers evidence of this potential. Meanwhile, there are several conditions for the application to work. First, it is important to select efficient growth poles that have not only a large growth potential, but also an advanced supply-demand and market relations, so that propagation effects can take place effectively through various channels. The selected regions should be able to internally attain economies of scale, as well as to externally achieve localization along with associated industries. Additionally, technological advancement and innovations are key requirements for the growth pole to have terminal effects on the whole economy. Second, the unbalanced development that is a crucial shortcoming of the growth-pole strategy should be minimized. As limited resources are concentrated on selected regions, regional discrimination tends to worsen following fast industrialization. In order to ameliorate such a problem, urbanization should take place as economic growth progresses. The high urbanization rate of the African continent that exceeds any other region in the world can be an asset. The following table compares the rate of urban growth in various regions in the world.

Table 4 .Urban Growth Rate in Different Regions (%)

Region	1950-55	1980-85	2000-2005	2010-15	2025-30
World	3	2.7	2.1	1.9	1.5
Africa	4.7	4.3	3.9	3.2	2.9
Asia	3.5	3.6	2.5	2.3	1.8
Europe	2	0.79	0.21	0.17	0.14
The Caribbean	4.4	3	2	1.5	0.98
North America	2.7	1.2	1.4	1.2	0.86
New Zealand	2.8	1.2	1.4	1	0.82

**Source: Maddison, Angus (2003), The World Economy: Historical Statistics. OECD, Paris*

As the table shows African cities grow faster than those of other regions. Now, 40 percent among the 1 billion African people live in cities. The urbanization drives development in Africa by boosting productivity, demand, and investment, taking use of economies of scale. Given the vast landmass and scarce capital, focused efforts to build a growth pole would be more feasible for Africa's development. It will increase efficiency of investment to develop a core region in the urban area, which would act as a catalyst to growth in the neighboring regions. The growth pole strategy may fit for African development considering its geographical and economic environment.

There are many options to build growth poles in Africa according to the regional scale. At the level of an individual country, each country may consider developing certain cities as growth poles, while groups of countries may try to develop regions as specified growth poles such as export pole, tourism pole, IT pole, etc. Establishing special economic zones or international integration among related countries would help implement these ideas. Developing growth poles would attract foreign investment more easily due to higher efficiency.

III.3. Possible Scenarios for African economic growth ⁷⁵

⁷⁵ The discussion on growth scenario will be focused on mainly Sub-Saharan region, because the northern Africa has relatively better economic condition considering their absolute income level.

Comparison with Fast-growing Group (FGG): Export-Driven Growth

If African countries adopt the above-mentioned growth strategies, the fast growing countries in the region will be a reference for other countries. Let us pay attention to the four fastest growing countries among the non-oil exporting countries: Botswana, Mozambique, Tanzania, and Uganda. This Fast-growing Group (FGG) demonstrated an average growth rate of 6.8% between 2000 and 2008. The table below summarizes the average growth rate of each GDP component in FGG compared to that in Sub-Saharan Africa between 2000 and 2008. The exports growth rate in this group is significantly higher than that of the Sub-Saharan Africa, while government expenditure, fixed investment, and imports grow slower in FGG. Strong export growth has led economic growth in these fast growing countries.

Table 5. Components of Economic Growth between 2000 and 2008: FGG and Sub-Saharan Africa (SSA), in percent

	FGG	SSA excluding FGG
Real GDP Growth	6.8	4.2
Private Consumption Growth	6.8	5.1
Government Expenditure Growth	7.4	8.5
Fixed Investment Growth 1/	7.6	10.9
Exports Growth	12.4	5.7
Imports Growth	7.4	8.5

Source: Global Insight. 1/ Fixed investment constitutes a relatively minor share of GDP.

These countries are dependent on export revenues to finance investment and consumption. FGG supports an optimistic prediction about the region's growth, in that the countries without oil resources, such as Mozambique and Tanzania are showing relatively high growth rates of approximately 6-7%. Even though the countries in the FGG are not oil-exporters, exports remain a driving mechanism for economic growth. The main prerequisite for this pattern of economic growth may be the access to international trade, because even many resource abundant countries in Africa cannot increase their exports due to the lack of necessary infrastructure and international network for trade. Exports-led economic growth cannot take place instantly. It requires a longer term to take place due to technology transition, policy implementation, international cooperation, etc. Hence, it takes time for Sub-Saharan countries to follow the growth strategy of FGG.

Comparison with Emerging Economies: The Capital Market Approach

IMF named eight Sub-Saharan African countries that are showing high growth rates as the Second-Generation Emerging Market (SGEM) focused on their potential economic growth in its September 2008 issue of *Finance and Development*.⁷⁶ The countries in Sub-Saharan Africa are classified as emerging markets; if they have financial markets and attract investor interest. Nellor (2009) suggests to apply the following questions as criteria to discern the “emerging

⁷⁶ The Term “emerging market” was coined by International Finance Corporation (IFC) in 1980 to refer to developing countries with stock markets that were beginning to demonstrate the features of the mature stock markets in industrial countries. IFC introduced new term “frontier markets” to describe countries with markets that are smaller and less liquid than those in the more advanced emerging market. Nellor (2009).

market’’: First, has there been a takeoff in growth? Second, is growth led by the private sector, and has public policy embraced market-led growth? Third, are there financial markets in which to invest?

The SGEM consists of Botswana, Ghana, Kenya, Mozambique, Nigeria, Tanzania, Uganda and Zambia, who account for approximately 40 percent of the region's population outside South Africa and almost one-half of its GDP. The eight SGEM countries recorded high economic growth rate of 8% during the period between 2000 and 2008, which is considerably higher than the average growth rate of Sub-Saharan Africa as a whole. Per capita GDP level for SGEM countries will be US\$10,282 in ten years and \$16,652 in twenty years,⁷⁷

The following table summarizes the average growth rate of each GDP component in SGEM and Sub-Saharan Africa, during the period of 2000 to 2008. Compared to Sub-Saharan Africa including SGEM, two distinct features are observed in SGEM. First, all the components are significantly high positive around 10% growth in every field. Second, fixed investment, imports, and exports grow considerably fast and lead the countries’ growth.

Table 6. Components of Economic Growth between 2000 and 2008: SGEM and SSA (%)

	SGEM	Sub-Saharan Africa including SGEM
Private Consumption Growth	8.6	6.0
Government Expenditure Growth	11.8	8.0
Fixed Investment Growth	16.3	11.5
Exports Growth	9.7	5.4
Imports Growth	17.1	8.9

African SGEM countries are very active in all economic fields from private consumption to exports. They import investment goods and expanded fixed investments to produce export goods. This pattern is not much different from that of advanced emerging markets. Distinctive features with the SGEM countries’ growth pattern are high fixed investment growth and imports growth. Imports grow even much faster than their exports. These growths can be only realizable if they are able to attract external capital inflows. The open capital market has worked as the channel to induce foreign investment, which contributes to economic growth.

Can other Sub-Saharan African countries follow the growth path of SGEM? Table 3 compares the growth rate of Sub-Saharan region with that of developing countries and emerging economies. Sub-Saharan African countries have already caught up with the real GDP growth rate of developing countries, although not with emerging economies. Sub-Saharan countries show higher growth rate than emerging economies in private consumption, government expenditure, and fixed investment. However, they grow slower in both imports and exports. Moreover, investment does not seem to have caused export growth unlike the case of SGEM.

Table 7. Average Growth Rate (%)

⁷⁷ According to Global Insight, the estimated population growth rates are 1.8% between 2011 and 2020 and 1.4% between 2021 and 2030.

	Emerging Markets		Developing Countries		SSA Countries	
Period	1990~99	2000~08	1990~99	2000~08	1990~99	2000~08
GDP	3.5	6.0	2.5	4.8	1.9	4.9
Private Consumption	3.8	5.4	3.0	4.7	2.8	6.1
Gov. Expenditure	3.2	5.0	2.0	5.5	1.0	7.9
Fixed Investment	4.9	9.3	6.3	7.3	2.4	11.6
Exports	7.1	10.8	4.8	6.4	0.8	5.3
Imports	7.6	11.9	1.9	7.7	1.9	8.8

Even though Sub-Saharan countries have achieved high growth, they remain exposed to high volatility. All GDP components appear to be highly volatile in Sub-Saharan Africa compared to SGEM countries. This remains a challenge for medium to long term growth.

Possible Scenarios for African Economic Growth

In this section, we examined the possible economic growth path that follows fast growing SSA countries and the pattern of Second-Generation Emerging Markets, which are also currently showing rapid growth in Sub-Saharan Africa. The exports-led growth strategy requires access to the international trade market, which would take time. The emerging market strategy needs a relatively open financial market, in which the private sector is the key driver of growth.

There is no specific strategy that fits all the economies in Sub-Saharan region. Each country should pick up a strategy which would be most suitable for its own economy. However, any strategy requires careful preparation. Establishing and opening, and operating a financial market, takes much time and effort. Infrastructure for trade would also require much investment.

The discussion on possible growth scenarios emphasized that the international linkage is essential to accelerate economic growth, regardless of which strategy a country would choose. FGG countries use exports as a vehicle for economic growth, whereas the SGEM uses foreign capital as an instrument for growth. Moreover, growth rates of exports and imports demonstrate the continent's potential as a huge market. If economic growth in Sub-Saharan Africa takes off as considered in this section, the region can contribute to global economic growth in an unprecedented manner with increasing international linkages.

III.4. Conclusion: Africa as a New Source of Global Economic Growth

Africa has shown unprecedented economic growth since 2000. There are fundamental changes going on in the continent showing an improving economic and socio-political environment. Higher economic growth resulted from these changes. Some countries adopted an export-led growth strategy and achieved over 6 % annual growth rates. Other countries realized high economic growth by using foreign capital as a trigger to expand production capacity. Even though there are still many vulnerable factors that may destabilize the economic environment, African economies showing positive signs of continuous growth. Especially, the resilience that fast growing economies have shown after the global crisis points to a stable trend of economic growth in Africa.

The flying-geese model and the growth pole strategy may be adopted if the leading group gains a stable basis to become a first runner of geese or a growth pole. All the fast growing countries in Africa are connected to the international market via trade or capital flows. The followers will, however, take time to join the advanced African countries. International cooperation may be needed to shorten time and lessen the burden.

African economies are expected to become a new source of global economic growth. If other African countries would catch up the recorded 7% rate of fast-growing countries in Sub-Saharan Africa, and continue to grow by this rate for another ten years, the GDP per capita on the continent will double and then quadruple in 20 years.

Africa's long-term economic potential including natural resources, a growing labor force, and rapid urbanization points to an economic boom in the African continent in the future. The McKinsey Global Institute (2010) estimated Africa's collective GDP in 2020 at \$2.6 trillion, and consumer spending at \$1.4 trillion. The institute states that Africa will play an increasingly important role in the global economy, if recent trends continue. On balance, Africa is emerging as a new source of global economic growth and it will play a significant role in rebalancing of the global economy. As we examined here, Africa has a large potential not only as a source of economic growth for the global economy, but also as a profitable market with a large population. Hence, supporting the region's current efforts to realize its economic development potential will eventually be beneficial to the world as a whole.

CONCLUSIONS

Africa's impressive pre-crisis growth and its fast and strong rebound from the crisis have reconfirmed the continent's immense economic potential. Still, growth was not sufficient to reach the MDGs or even meaningfully reduce the income per capita gap with the advanced economies. Bringing Africa on a strong, sustainable and shared growth path is thus a key policy priority. The main pillars for achieving this type of growth are:

- **Flexible, but credible macroeconomic frameworks.** As policy moves from overemphasizing stability to focusing on growth, countries need to utilize their policy space judiciously. Past procyclical policies should be replaced by rule-based counter-cyclical frameworks that still leave room for discretion whenever needed.
- **A vibrant private sector and productive entrepreneurship** across regions and sectors supported by well-designed industrial policy. Industrial policy should not pick winners, but remove obstacles in high-potential sectors and industries.
- **Social safety nets** to protect the most vulnerable in the case of shocks. Social protection programs need to be built to ensure shared growth in the medium term.
- **Inclusive financial system**, with fewer obstacles to accessing credit, especially for small exporters, SMEs and smallholder farmers. Innovative methods, such as leveraging remittances, can help 'bank the unbanked'.
- **Trade, FDI and Regional Integration.** Global trade and investment are key components of strong economic growth. As the financial crisis showed, regional integration can be a great source of resilience and growth, and should be encouraged – not only in trade but also in intra-continental investments.

- **A stronger human capital base** is needed to transform African countries into knowledge-based societies. Reforming higher educational systems, including their financing, would reduce the mismatch between the demands of modern economies and skills of the recent university graduates in most African countries.
- **Modern and well-maintained infrastructure.** Africa's current infrastructure deficit severely constrains its prospects for growth and urgently needs to be closed. Innovative forms of financing need to be utilized, including local currency infrastructure bonds, sovereign bonds and sovereign wealth funds for infrastructure.
- **Adoption of low-carbon technology.** African countries should actively utilize projects boosting green industries, such as clean energy or green agriculture. They are well positioned to do so given the continent's abundant natural resources.
- **Amplified Africa's voice.** Africa's representation in the key policy and decision making international structures needs to be enhanced. Greater scope is also needed for African-led institutions to engage on equal terms in global discussions.

To conclude, Africa has changed – from a historically slow growth region to one of the fastest growing regions in the world. If reinforced, emerging positive perceptions would lead to even more private investment, increased trade, and accelerated growth in Africa. If Africa can achieve at least two decades of annual average growth at or above 7 percent a year, it would become a new source of dynamism in the global economy -- not only through exports, but also as a major consumer market. While Asian markets continue their rapid expansion, China and India would have to increase their consumer spending markedly and quickly just to replace the demand lost by the United States in the past two years. Supporting Africa's efforts to realize its immense economic potential would thus soon be beneficial to the entire world.

In Africa an alternative can be found to what is now the new normalcy in the global economy of low growth, high unemployment and instability on the one hand, and high absolute poverty and underutilized human potential on the other. Poverty can be substantially reduced by growth that is strong, shared and sustained. The world needs a new driver of consumer demand, a new market, and a new dynamo, which can be Africa. Future growth in the world economy and in the developing world will depend on harnessing both the productive potential and the untapped consumer demand of the continent. Therefore, every job not created, every business lost and every entrepreneurial idea not realized in Africa are drivers lost to global growth.

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APPENDIX TABLES AND GRAPHS

Table A.1. Selected Macroeconomic Indicators Prior, During and After the Last Two Crisis

	1986-90	1991	1992	1993	2004-08	2009	2010	2011
	before crisis				before crisis			
	Middle Income Countries							
Real GDP growth (%)	4.0	3.6	2.7	1.2	5.5	0.4	3.6	4.1
Inflation (%)	8.3	10.1	9.6	9.4	5.6	7.8	5.2	5.0
Current account balance (% of GDP)	-1.6	-0.7	0.1	-0.6	5.4	-2.0	-0.1	0.6
Fiscal balance (% of GDP)	-5.2	-1.5	-2.2	-4.5	3.9	-1.3	-1.1	-0.5
	Low Income Countries							
Real GDP growth (%)	2.6	0.3	-1.0	0.2	5.8	3.2	4.8	5.3
Inflation (%)	21.3	20.5	22.1	19.9	8.6	8.6	6.6	5.7
Current account balance (% of GDP)	-7.0	-7.1	-8.9	-8.3	-7.9	-11.6	-10.7	-10.7
Fiscal balance (% of GDP)	-6.6	-8.2	-8.0	-7.4	1.0	-1.3	-1.9	-2.7
	Low Income Countries, Frontier Markets							
Real GDP growth (%)	4.8	0.1	0.3	4.3	6.4	4.4	5.3	6.0
Inflation (%)	41.9	27.9	40.7	44.4	9.1	9.0	7.8	6.5
Current account balance (% of GDP)	-5.2	-5.2	-5.6	-7.7	-5.2	-8.6	-7.8	-6.9
Fiscal balance (% of GDP)	-7.8	-3.3	-4.8	-6.6	-1.8	-4.9	-4.6	-4.0
	Low Income Countries, Fragile States							
Real GDP growth (%)	-0.3	-1.8	-7.1	-8.9	7.0	3.5	6.2	5.4
Inflation (%)	25.6	40.1	32.0	23.7	10.2	13.2	9.9	7.8
Current account balance (% of GDP)	-5.9	-3.9	-9.8	-7.1	-7.9	-16.3	-13.5	-13.5
Fiscal balance (% of GDP)	-7.8	-18.1	-11.9	-9.5	2.7	-0.8	2.0	-0.2

Source: Authors' calculations based on the African Development Bank database.

Figure A.1.a. Inflation and growth in Africa's LICs, 1990-1999

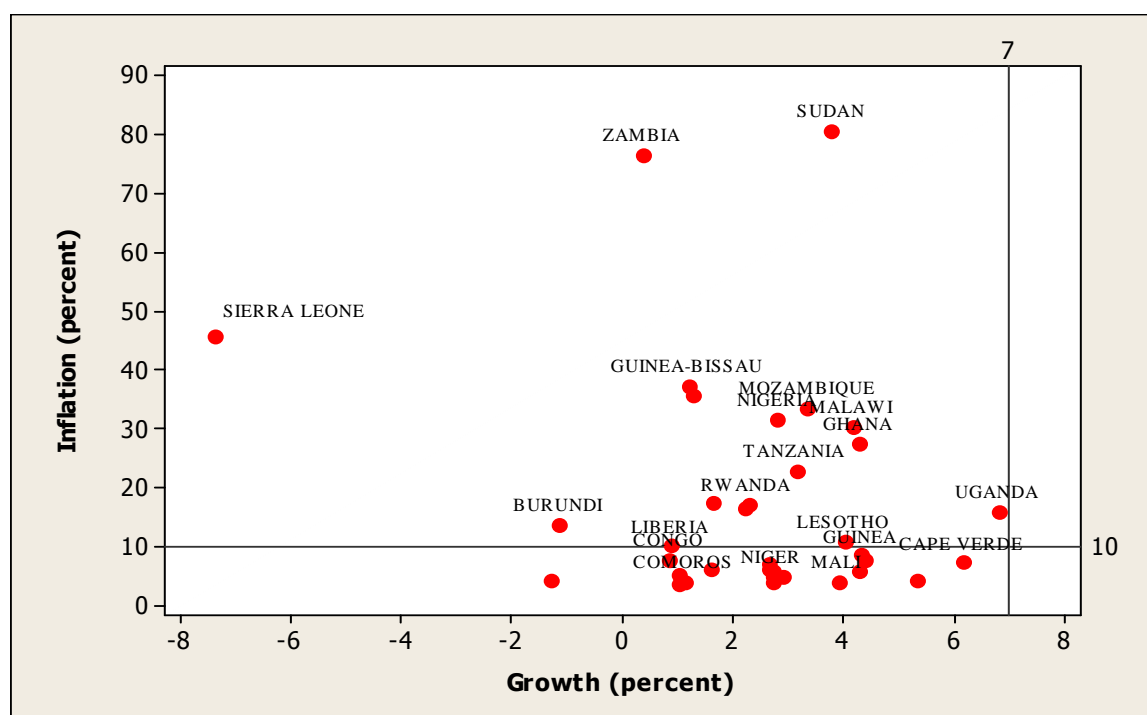
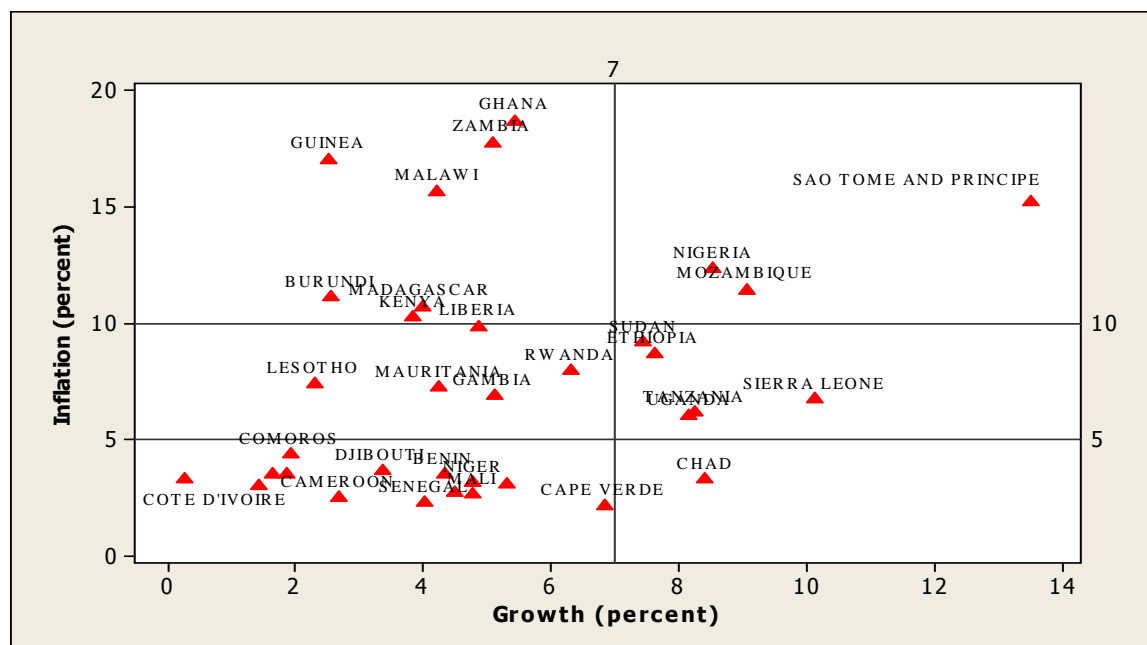


Figure A.1.b. Inflation and growth in Africa's LICs, 2000 - 2008



Source: Authors' calculations based on the African Development Bank database.

Figure A.2.a. Real GDP growth and inflation in oil exporters and importers

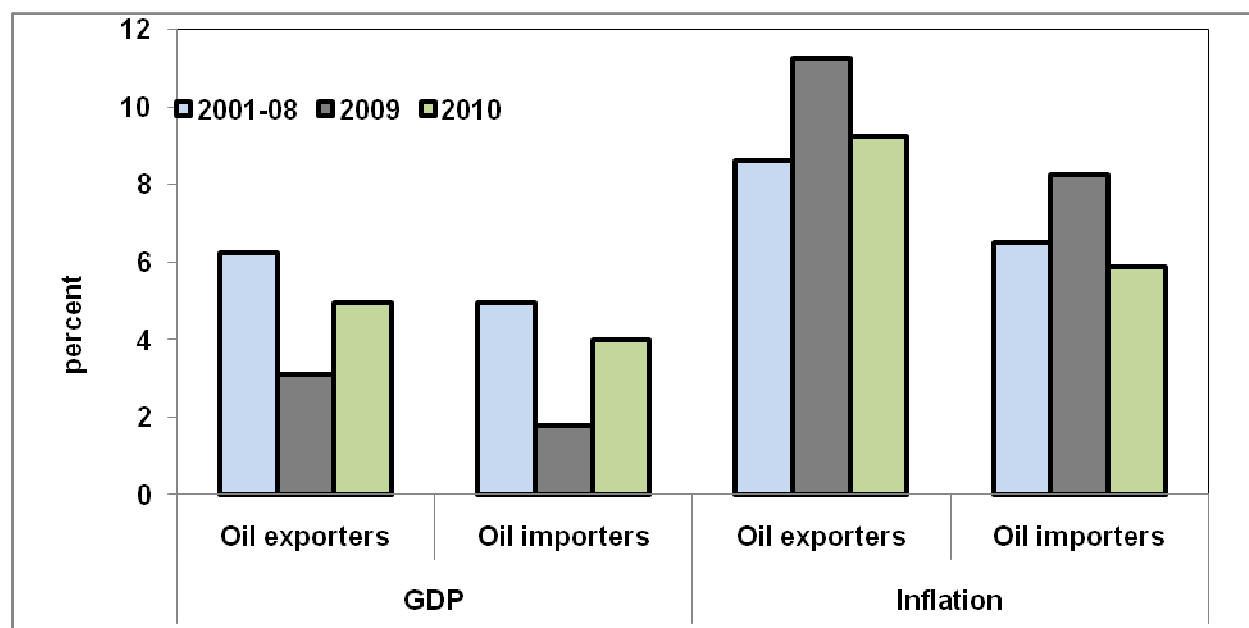
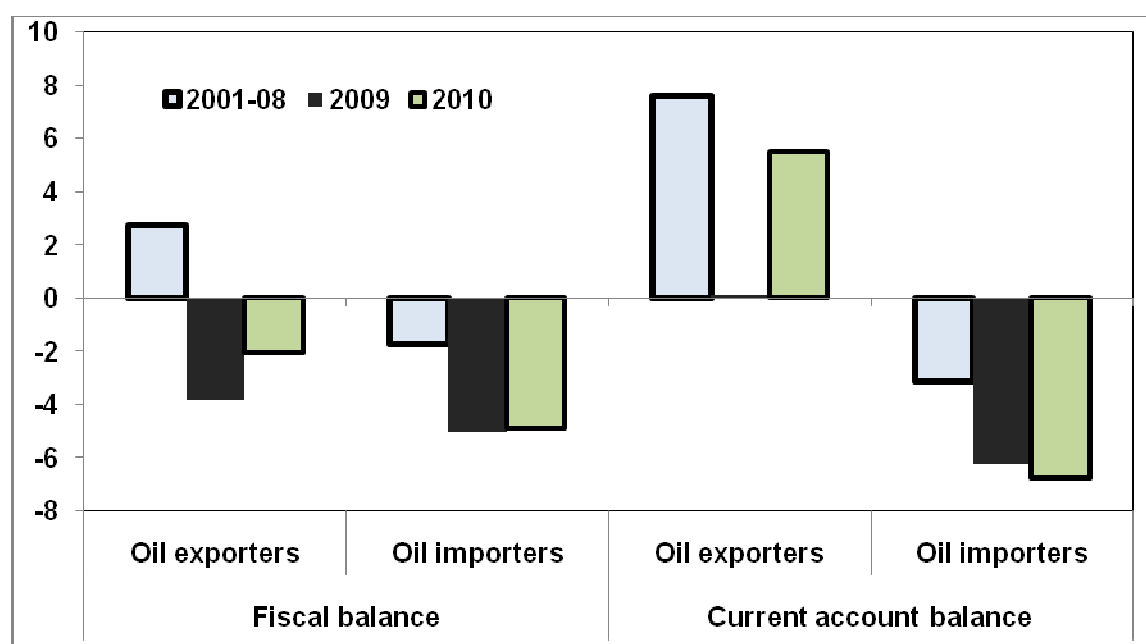


Figure A.2.b. Fiscal and current account balance in oil exporters and importers



Source: Authors' calculations based on the African Development Bank database.

Figure A.3.a. Africa's frontier markets: average and standard deviation of growth

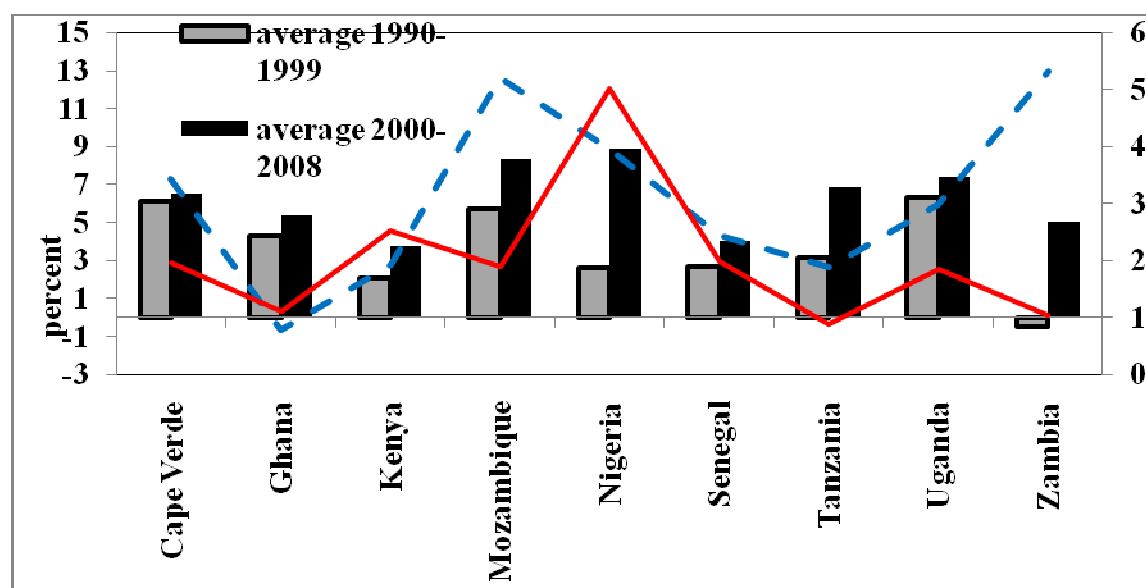
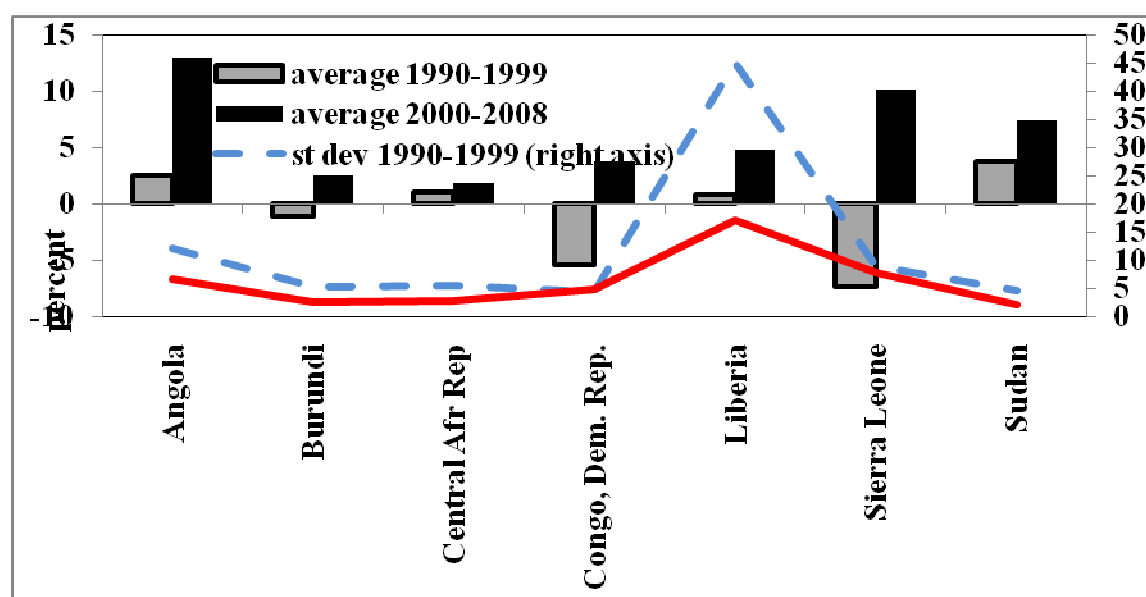
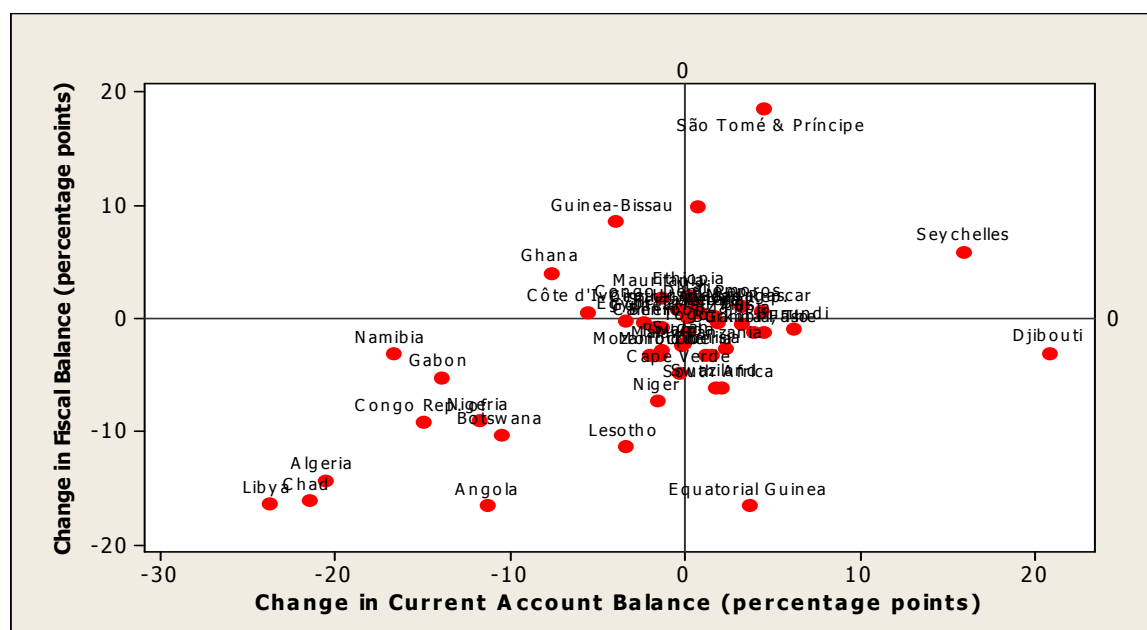


Figure A.3.b. Africa's fragile states: average and standard deviation of growth



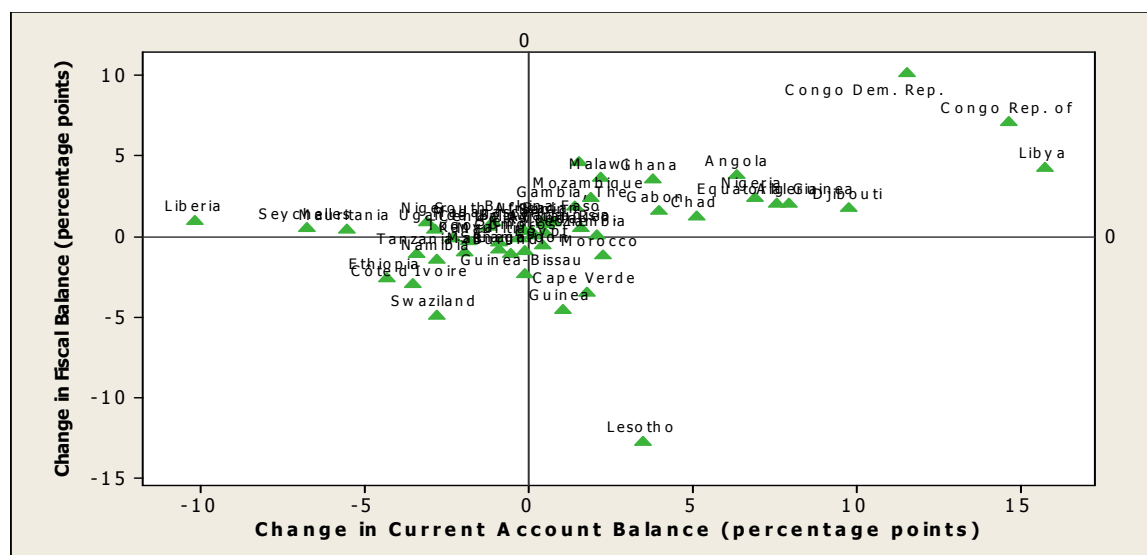
Source: Authors' calculations based on the African Development Bank database.

Figure A.4.a. Changes in fiscal and current account balances in Africa, 2009 vs. 2008 1/



1/ Negative sign means deterioration in 2009. Both fiscal and current account balances include grants. Correlation coefficient is 0.537 at 1 percent significance level.

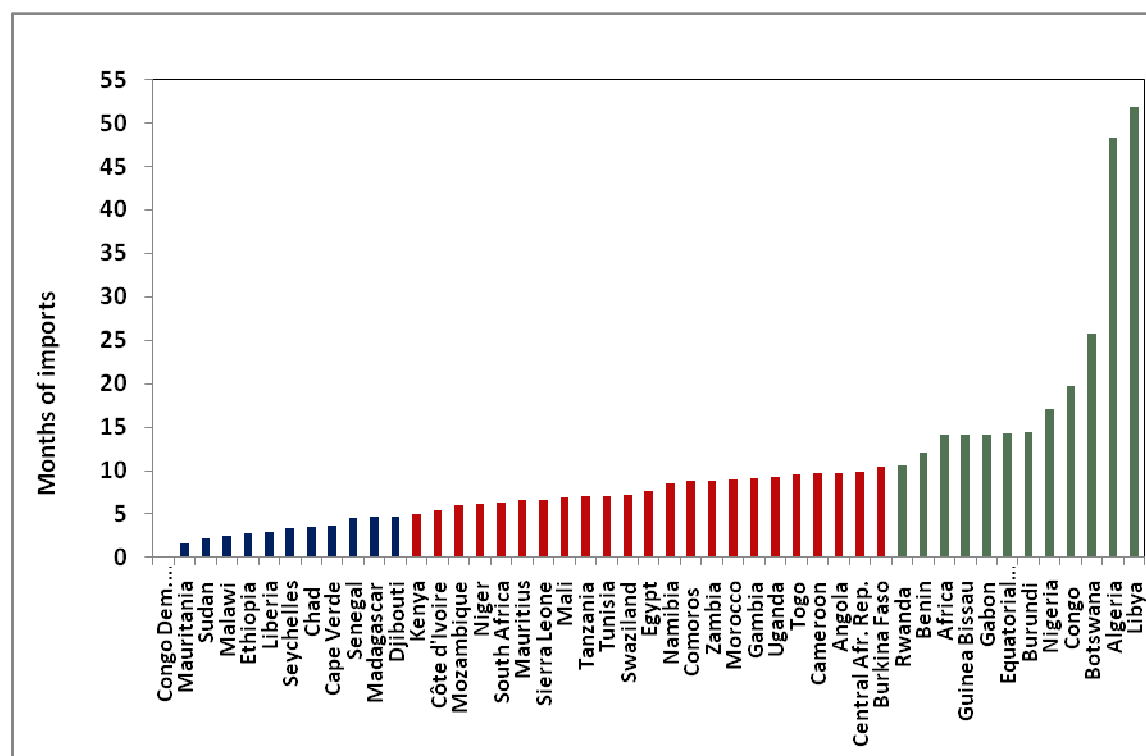
Figure A. 4.b. Changes in fiscal and current account balances in Africa, 2010 vs. 2009



1/ Negative sign is deterioration. Fiscal and current account balances include grants. Correlation coefficient is 0.477 at 1 percent significance level.

Source: Authors' calculations based on the African Development Bank database.

Figure A.5. Foreign exchange reserves, end-2009



Source: Authors' calculations based on the African Development Bank database.

Figure A.6.a. Fiscal degree of freedom 1: fiscal deficit, 2010 (projection), percent of GDP

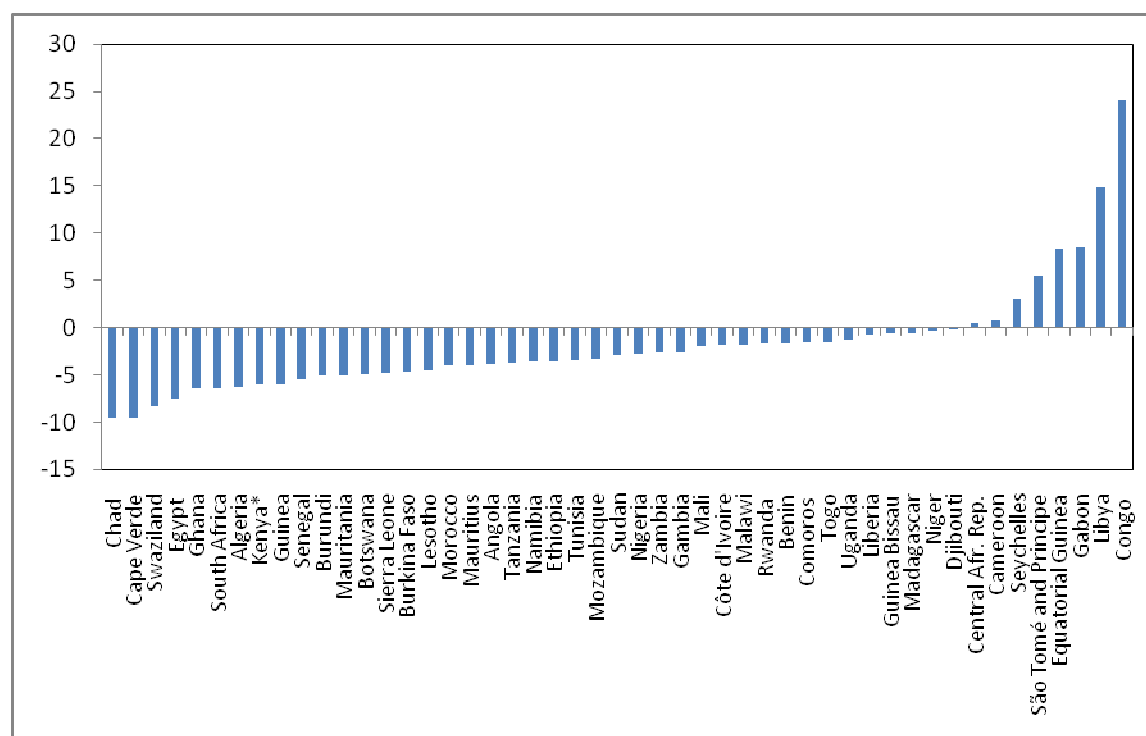
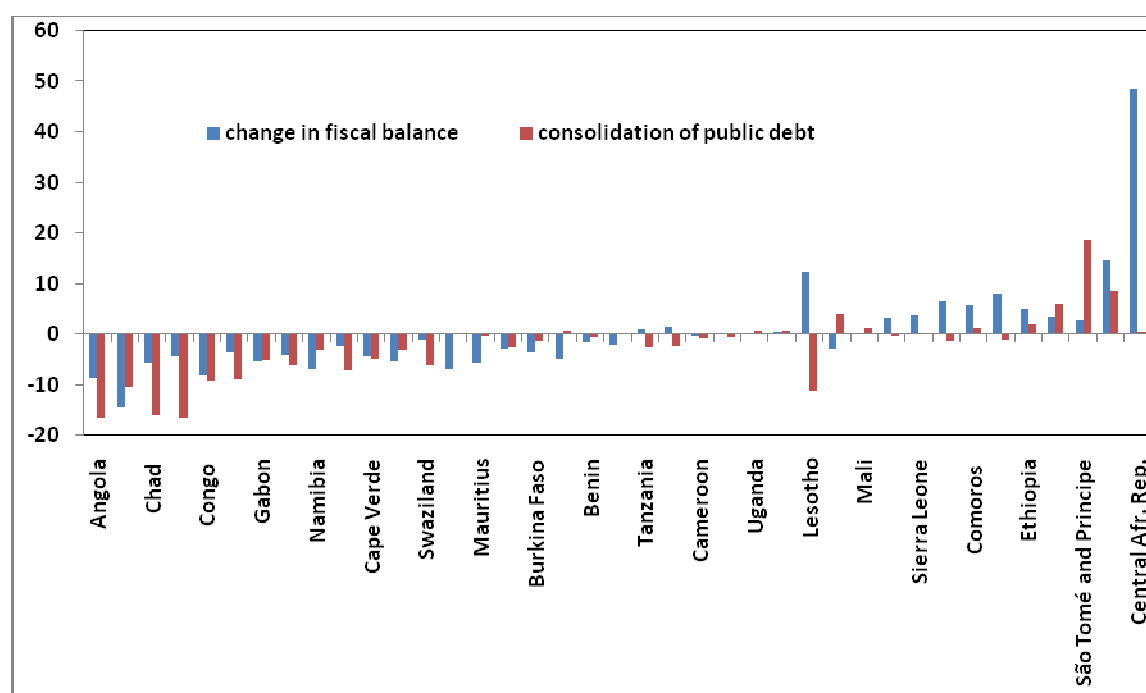
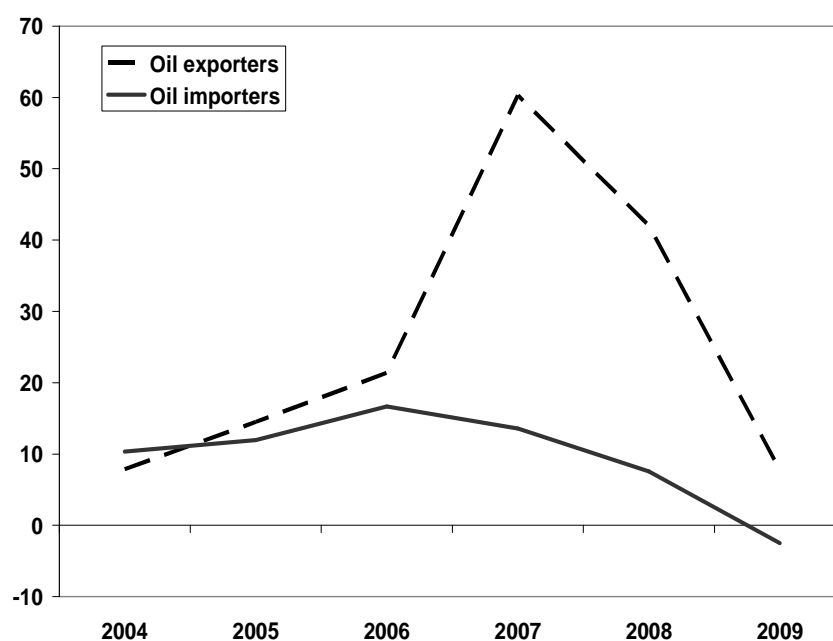


Figure A.6.b. Fiscal degree of freedom 2: size of the fiscal shock, 2009 (percent of GDP)1/



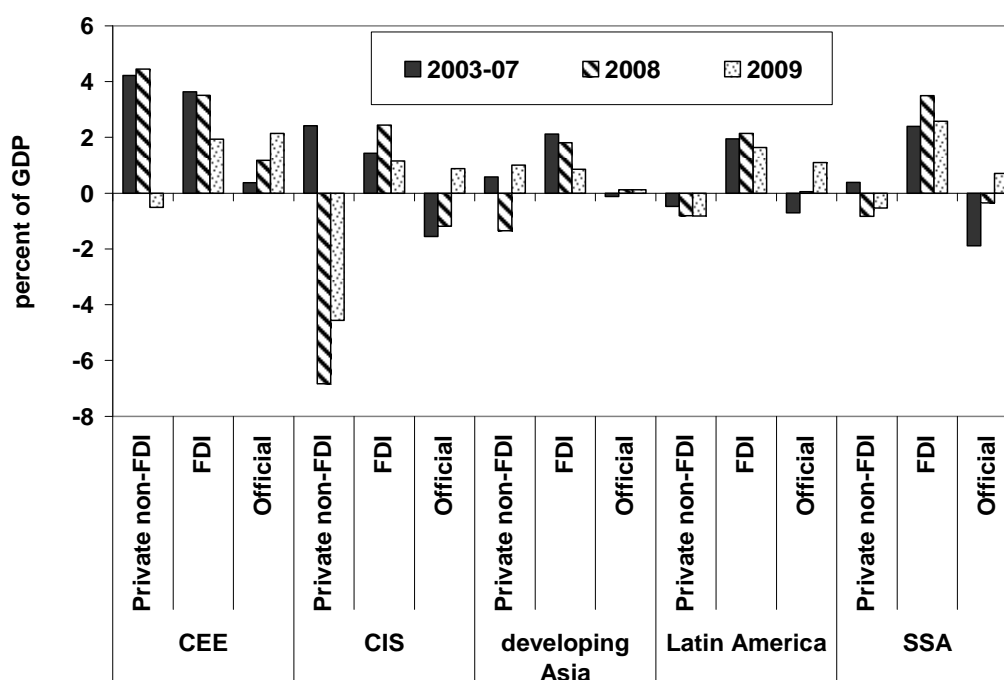
Source: African Development Bank and authors' calculations. 1/Negative numbers mean deterioration of the fiscal balance and increase of public debt in 2009 from 2008. Together, they constitute a fiscal shock.

Figure A.7. Growth of Real Credit to the Private Sector in SSA, 2003 – 2009 (%)



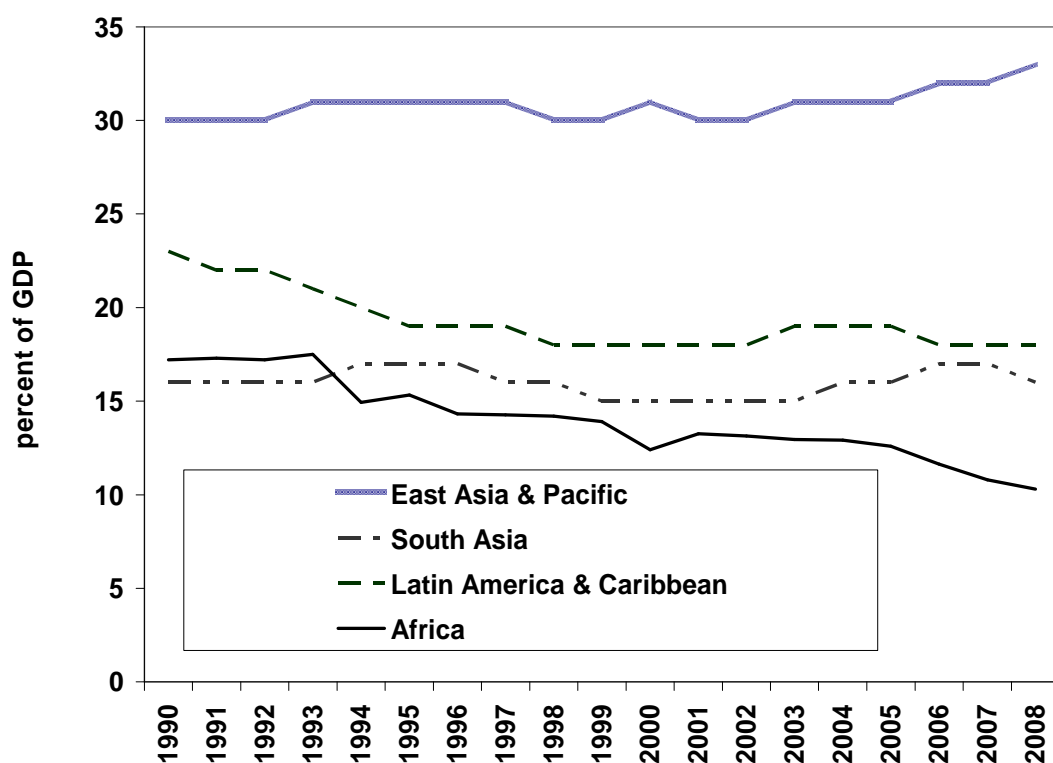
Source: Authors' calculations based on the IMF (2010).

Figure A.8. Private and Official Flows before and during the Crisis, 2003-07, 2008 and 2009
1/



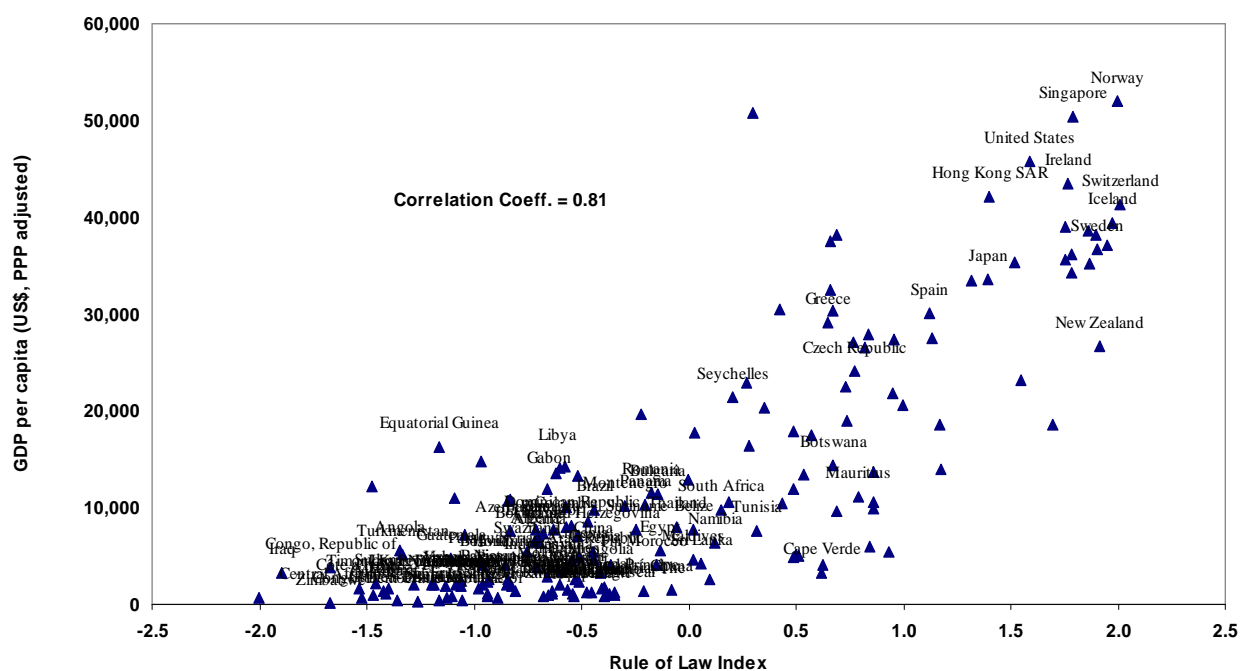
Source: Authors' calculations based on the IMF WEO database (April 2010). 1/CEE denotes Central and Eastern Europe and CIS stands for the Commonwealth of Independent States.

Figure A.9. Share of manufacturing in GDP, 1990 - 2008



Sources: African Development Bank, World Bank and authors' calculations.

Figure A.10. GDP per capita and rule of law index, 2007



Sources: World Economic Forum, World Bank and authors' calculations.

Figure A.11.a. Mobile phone subscriptions in frontier markets and India (2008)

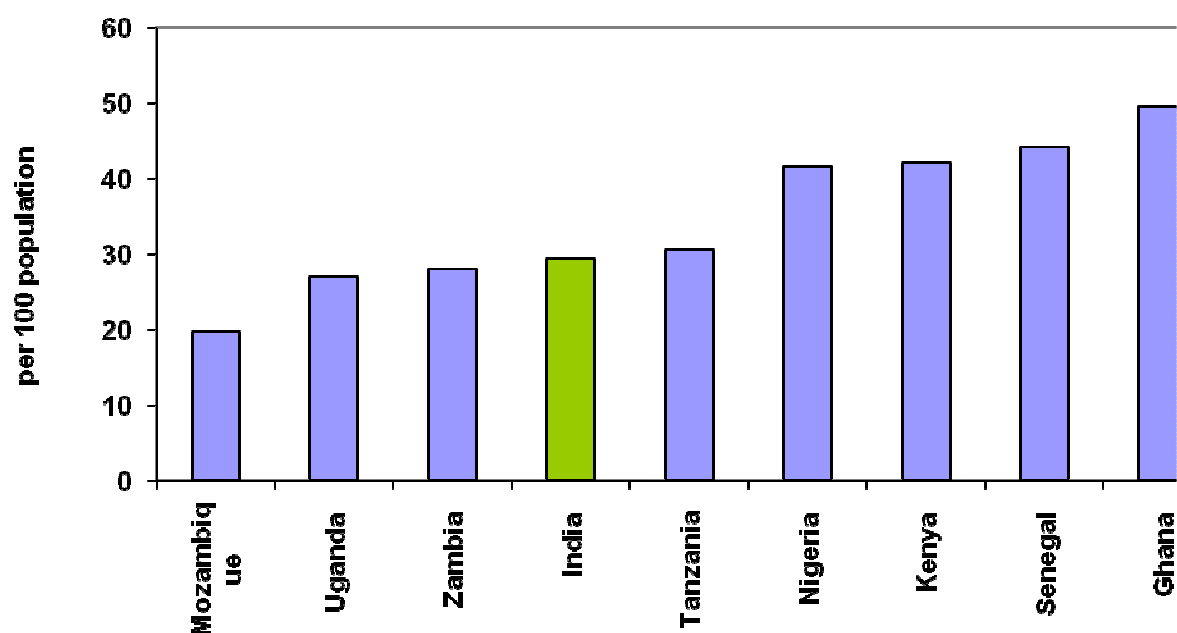
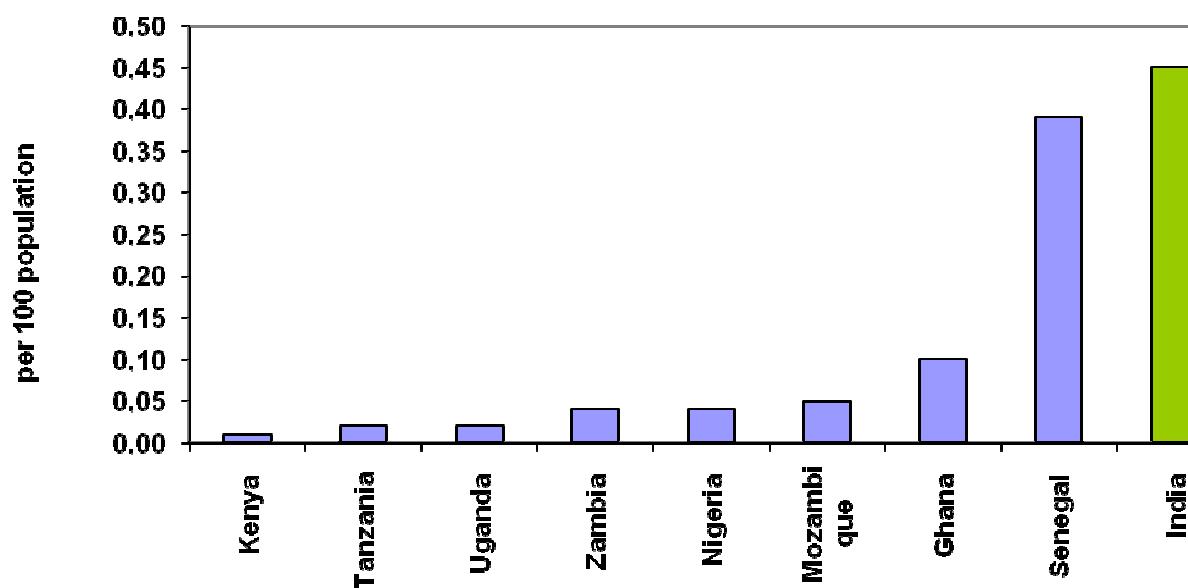
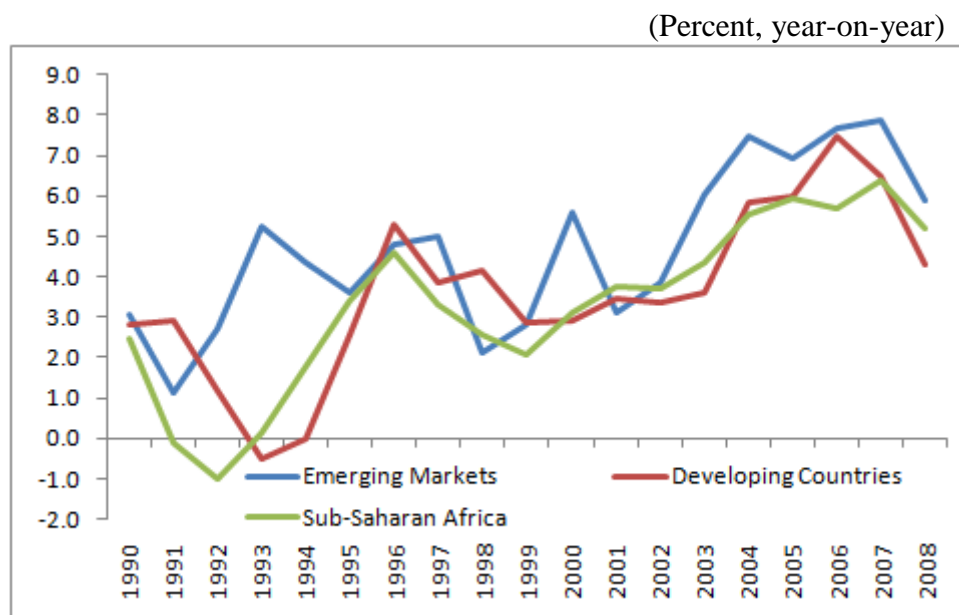


Figure A.11.b. Internet subscription in frontier markets and India (2008)



Source: ICT Readiness Report, 2009/10.

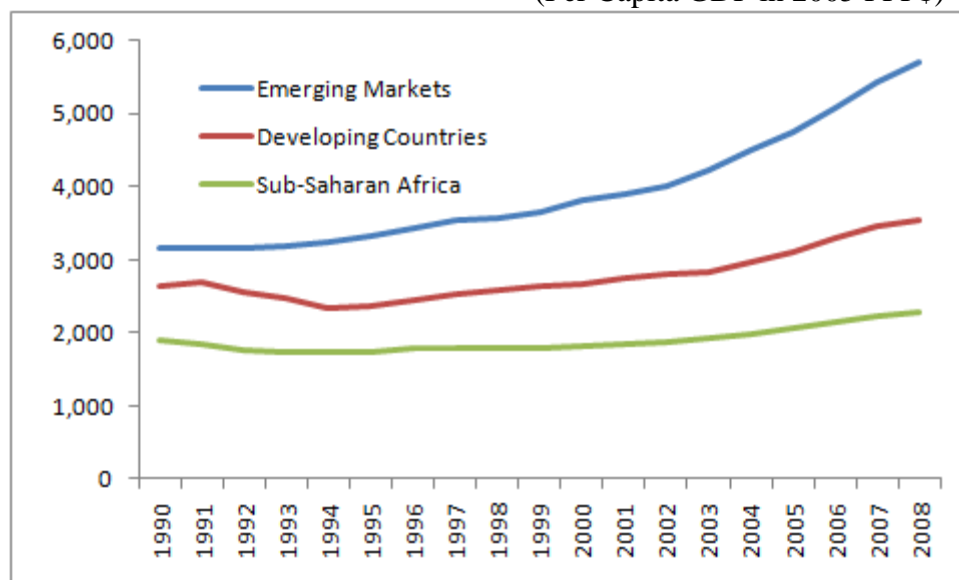
Figure A.12. Comparison of Growth Components: Emerging Markets, Developing Countries, Sub-Saharan Africa⁹⁸



Source: Global Insight

Figure A. 13. Real GDP at PPP per capita - Level

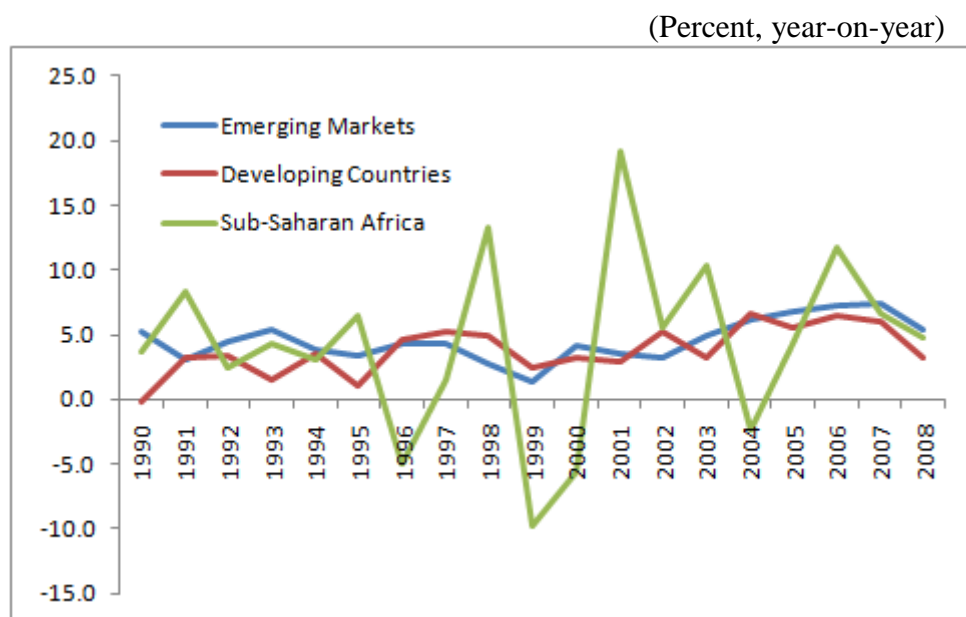
(Per Capita GDP in 2005 PPP\$)



Source: Global Insight

Figure A.14. Real Private Consumption - Growth

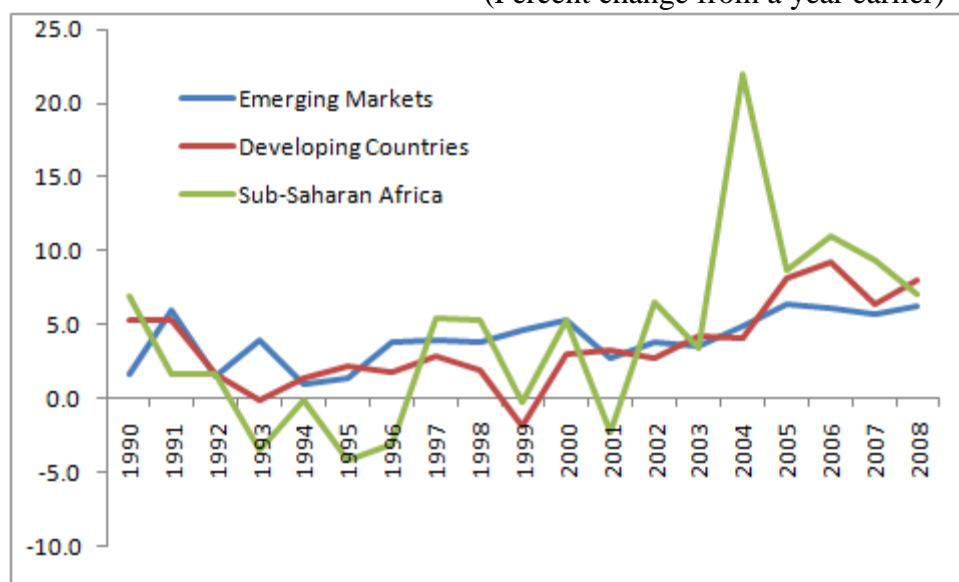
⁹⁸ Countries in each group are listed on the <A-Table 1>.



Source: Global Insight

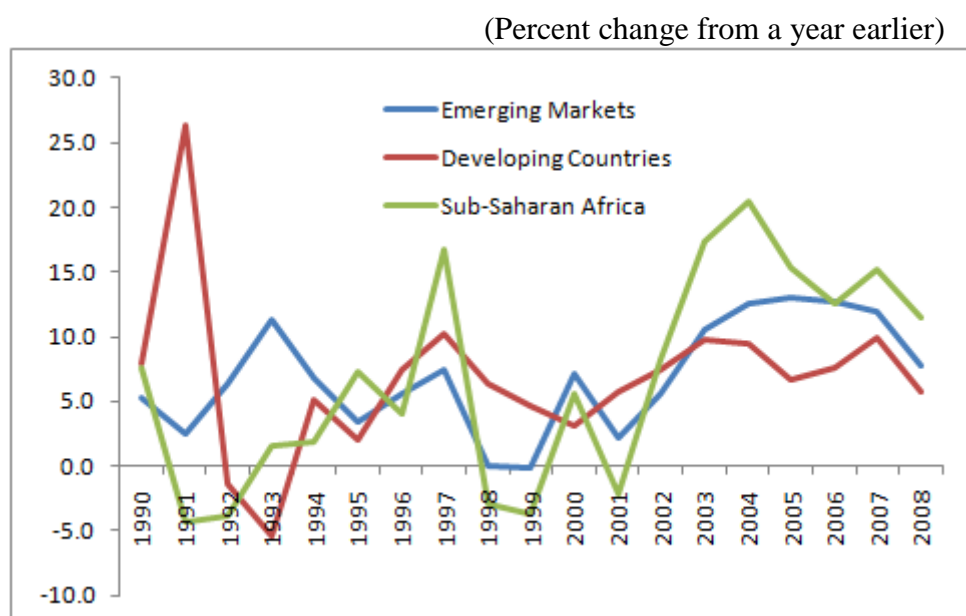
Figure A.15. Real Government Expenditure - Growth

(Percent change from a year earlier)



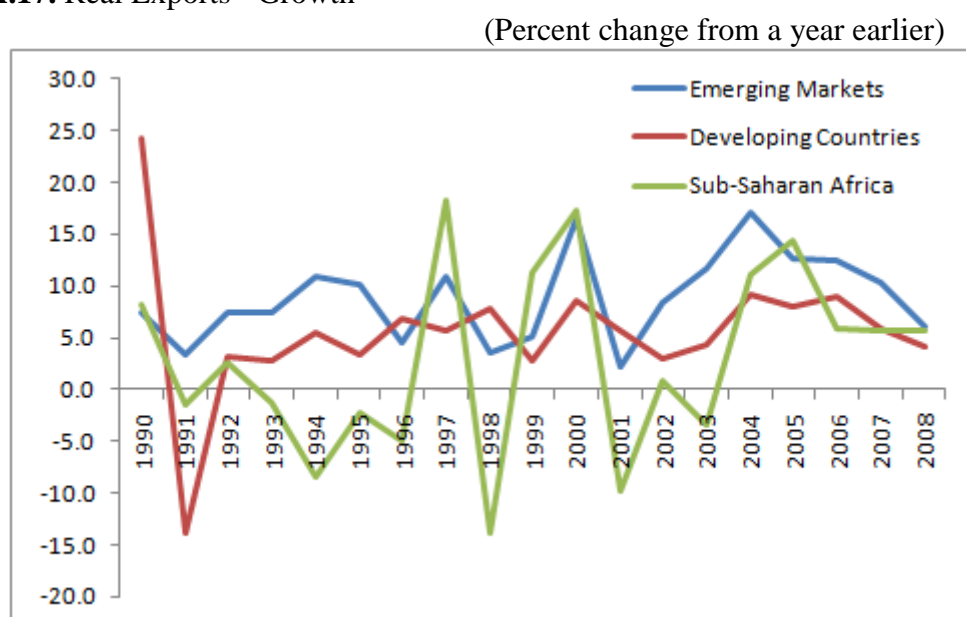
Source: Global Insight

Figure A.16. Real Fixed Investment - Growth



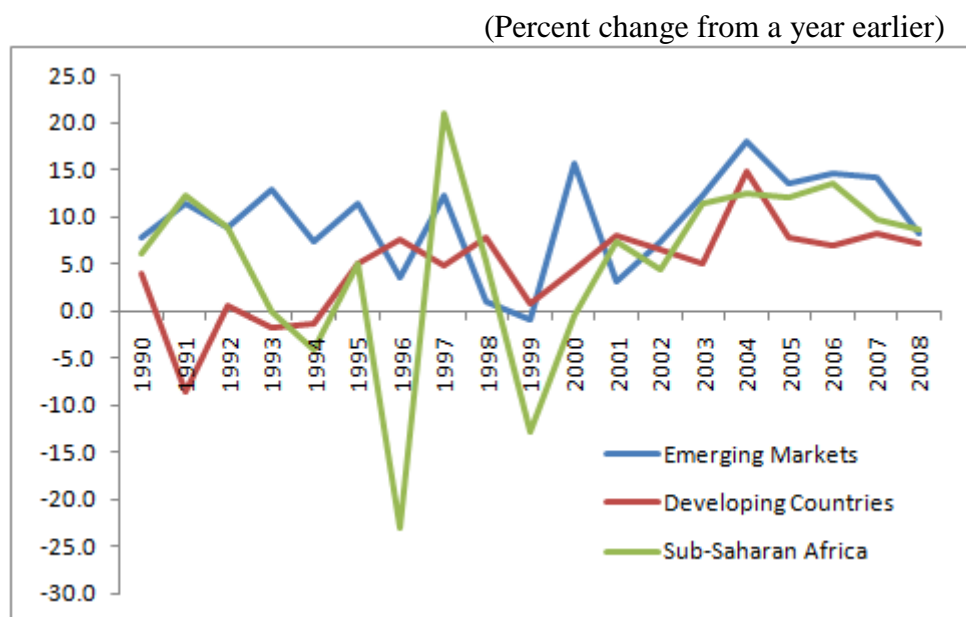
Source: Global Insight

Figure A.17. Real Exports - Growth



Source: Global Insight

Figure A.18. Real Imports -Growth



Source: Global Insight

Figure A.19.Forecast of Real GDP at PPP per capita - Level
(Per Capita GDP in 2005 PPP\$)

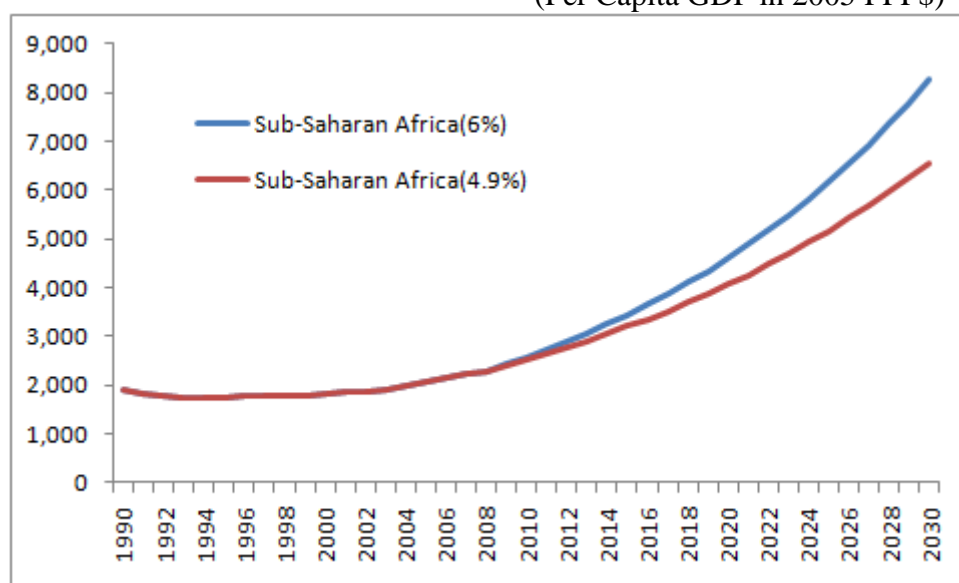


Table A.2: Countries in included Each Group

Developing Countries [118]		Emerging Markets [54]	SUB-SAHARANAFRICA [47]
Aruba	Laos	Argentina	Angola
Afghanistan	Liberia	Bahrain	Benin
Angola	Libya	Bangladesh	Botswana
Anguilla	St Lucia	Botswana	Burkina Faso
Albania	Lesotho	Brazil	Burundi
Andorra	Macau	Bulgaria	Cameroon
Netherlands Antilles	Moldova	Chile	Cape Verde
Armenia	Madagascar	China	Central African Republic
American Samoa	Maldives	Colombia	Chad
Antigua and Barbuda	Macedonia	Cote d'Ivoire	Comoros
Azerbaijan	Mali	Croatia	Congo, Republic of
Burundi	Myanmar	Czech Republic	Côte d'Ivoire
Benin	Montenegro	Ecuador	Democratic Republic of the Congo (former Zaire)
Burkina Faso	Mongolia	Egypt	Djibouti
Bahamas	Mozambique	Estonia	Equatorial Guinea
Bosnia and Herzegovina	Mauritania	Ghana	Eritrea
Belarus	Martinique	Hungary	Ethiopia
Belize	Malawi	India	Gabon
Bermuda	Niger	Indonesia	Gambia
Bolivia	Nicaragua	Jamaica	Ghana
Barbados	Nepal	Jordan	Guinea, Republic of
Brunei	Papua New Guinea	Kazakhstan	Guinea-Bissau
Bhutan	Puerto Rico	Kenya	Kenya
Central African Republic	North Korea	Kuwait	Lesotho
Cameroon	Paraguay	Latvia	Liberia
Congo	Reunion	Lebanon	Madagascar
Comoros	Rwanda	Lithuania	Malawi
Cape Verde	Sudan	Malaysia	Mali
Costa Rica	Senegal	Mauritius	Mauritius
Cuba	Solomon Islands	Mexico	Mozambique
Cayman Islands	Sierra Leone	Morocco	Namibia
Djibouti	El Salvador	Namibia	Niger
Dominica	Somalia	Nigeria	Nigeria
Dominican Republic	Serbia	Oman	Reunion
Democratic Republic of the Congo	Sao Tome and Principe	Pakistan	Rwanda
Algeria	Suriname	Panama	Sao Tome and Principe
Eritrea	Swaziland	Peru	Senegal
Ethiopia	Seychelles	Philippines	Seychelles
Fiji	Syria	Poland	Sierra Leone
Micronesia	Chad	Qatar	Somalia
Gabon	Togo	Romania	South Africa
Georgia	Tajikistan	Russia	
	Turkmenistan	Saudi Arabia	
		Slovakia	
		South Africa	

Guinea Gambia Guinea-Bissau Equatorial Guinea Grenada Guatemala French Guiana Guam Guyana Honduras Haiti Iran Iraq Kyrgyzstan Cambodia Kiribati St Kitts and Nevis Kosovo	East Timor Tonga Tuvalu Tanzania Uganda Uruguay Uzbekistan St Vincent and the Grenadines US Virgin Islands Vanuatu Palestinian Authority Samoa Yemen Zambia Zimbabwe	Sri Lanka Thailand Trinidad and Tobago Tunisia Turkey Ukraine United Arab Emirates Venezuela Vietnam	Swaziland Tanzania Togo Uganda Zambia Zimbabwe
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